Decision

RIIO-3 Sector Specific Methodology Decision – GD Annex

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Contact:	RIIO-3 Team
Team:	Network Price Controls
Email:	RIIO3@ofgem.gov.uk

We are setting out our decisions on the methodologies we will apply for the electricity and gas transmission and gas distribution sectors in the RIIO-3 price control, which will run from 1 April 2026.

Any enquiries related to the text of this publication should be sent to Ofgem at:

10 South Colonnade, Canary Wharf, London, E14 4PU.

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1. Introduction

Structure of this document and associated documents

1.1 In December 2023 we published our RIIO-3 Sector Specific Methodology Consultation (SSMC), which followed our October 2023 decision on frameworks for future systems and network regulation (this is referred to as our 'Framework Decision').

1.2 We are now publishing our Sector Specific Methodology Decision (SSMD) for RIIO-3, following further engagement with key stakeholders and a detailed review of the 59 responses to our SSMC. Our SSMD is comprised of an Overview Document, a Regulatory Finance annex (Finance Annex), and sector specific annex documents for gas distribution (GD), gas transmission (GT) and electricity transmission (ET).

1.3 The Overview Document provides detail on how we will apply the Framework Decision to areas that are relevant across the sectors. The decisions in the Overview Document apply across the GD, GT and ET network companies.

1.4 This document is focused on the application of the RIIO-3 framework to GD-specific issues. It sets out our sector specific views on the aspects of the RIIO-3 price control that gas distribution network companies (GDNs) need to understand to be able to put together their business plans.

What is gas distribution?

1.5 The GDNs are responsible for transporting gas locally to approximately 22 million homes and businesses, industry and power stations across Great Britain (GB).

1.6 Four GDNs own, operate and maintain the eight GB gas distribution networks:

- Cadent (East of England, North London, North West and West Midlands);
- NGN (Northern England);
- SGN (Scotland and South East England); and
- Wales and West Utilities (WWU).

Challenges for RIIO-GD3

1.7 Natural gas continues to play a major role in the day-to-day heating of households, industrial processes and the generation of electricity. While the role of gas is expected to change as we transition to net zero, maintaining a safe and resilient gas network through the transition remains paramount.

1.8 For RIIO-GD3, we will continue to ensure that a secure, uninterrupted supply of energy to homes and businesses is maintained. The system must also be resilient to changing physical, financial and cyber risks. Furthermore, gas consumers should continue to receive a high quality of service at a reasonable cost, with the GDNs maintaining an important role in supporting and protecting their customers, especially those in vulnerable situations.

1.9 We do not anticipate that there will be large-scale, systematic changes to the gas networks during RIIO-3. As such, we consider that our approach to regulation does not need to change significantly from RIIO-GD2. However, we must ensure that our regulatory framework can respond to how the future unfolds.

1.10 While it is not known exactly how the United Kingdom (UK) will reach its statutory net zero target and five-year carbon budgets, researchers and policy makers are exploring potential pathways to hit climate targets in the most efficient and least disruptive way. This includes electrification, carbon capture, usage and storage (CCUS), low-carbon heat networks and hydrogen. Natural gas demand is expected to decline in all future pathways. However, each possible pathway could result in a very different future use of the gas distribution networks. It is therefore vital that RIIO-GD3 is adaptable to a range of potential future pathways, including the National Infrastructure Commission's recommendation that electricity provides the majority of home heating in the future.

1.11 The speed, timing and overall balance of repurposing, decommissioning and retaining natural gas assets will be influenced by future government decisions on how to reach the statutory net zero target and five-year carbon budgets. In particular, the UK government's:

- ambition to make a strategic decision on whether to use hydrogen for heating in 2026 will be of particular relevance for the GD network;
- development of a Hydrogen Transport Business Model (HTBM) to facilitate and support the development of hydrogen pipeline infrastructure, expected to be designed by 2025, could have important interactions with RIIO-3 funding; and
- decision on blending up to 20% hydrogen into the existing natural gas network could lead to additional GDN responsibilities.

1.12 In the scenario in which hydrogen plays a limited or no role in heating, we would expect a large share of the GD network to be decommissioned. If government decides that hydrogen will play a major role in heating, then large portions of the GD network may be repurposed. Decommissioning and repurposing will be

complex, multi-decade processes, requiring detailed planning, legislation, funding, public buy-in, and political commitment. Neither is likely to start at scale before the mid-2030s, but there is merit in beginning the debate on how to approach these challenges.

1.13 As such, we will continue to work closely with government, industry and consumer groups to help ensure the transition away from natural gas is fair and at the lowest possible cost. As part of this, we think government should develop a strategy for the future of gas to:

- set out how to plan, and pay for, potential decommissioning;
- consider whether further government intervention is required to support a declining consumer base to pay for historical investment in the gas network; and
- help inform strategic gas network planning led by the new National Energy System Operator (NESO) via its role as the Regional Energy Strategic Planner (RESP) for distribution-level strategic planning.

1.14 Our SSMD will help to ensure that GDNs respond to these challenges in their business plans. Highlights of our package, by outcome, that we expect the GDNs to deliver through RIIO-GD3 are set out below.

Infrastructure fit for a low-cost transition to net zero

1.15 It is vital that RIIO-GD3 is flexible to manage the uncertainty around the future of gas and to provide funding where appropriate. This will be achieved through a suite of uncertainly mechanisms that can flex funding up, and down, as need becomes clear. Our approach to managing the uncertain future of gas in RIIO-3, including in relation to hydrogen and potential decommissioning, is addressed in Chapters 4 and 8 of the Overview Document, and Chapter 2 of this document.

1.16 A key decision for RIIO-GD3 is how quickly to pay back the historical and future gas network investment through regulatory depreciation charges from a declining customer base. While accelerating regulatory depreciation will add to network charges, we consider it is important for us to act to ensure intergenerational fairness and to protect both future consumers and investors against the perceived risk of asset stranding. This is considered in Chapter 4 of the Overview Document and Chapter 9 of the Finance Annex.

1.17 We also recognise the importance for the GDNs to minimise their direct impact on the environment to support net zero. To facilitate this in RIIO-GD3, we will place a greater prominence on reducing greenhouse gas emissions - especially methane

which is a potent greenhouse gas (see Chapter 6 of the Overview Document and Chapter 2 of this document). This includes:

- providing dedicated funding for the management of shrinkage,
- encouraging GDNs to embrace rolling out new techniques to help monitor and manage the gas lost from their network; and
- requiring increased transparency on the GDNs' actions, plans and progress to decarbonise in line with net zero.

Secure and resilient supplies

1.18 The importance of maintaining a safe and resilient network remains paramount during RIIO-GD3 and is discussed in Chapter 3 of this document. This includes continuing the investment required to maintain safety and replace deteriorating iron pipes (repex) - which will remain the predominant driver of costs in RIIO-GD3. Delivering the repex programme will also continue to substantively drive down harmful methane emissions during RIIO-3 by reducing the volume of gas lost from the network.

High quality of service from regulated firms

1.19 It is important for GDNs to continue to deliver a high quality of service to customers. This includes supporting and protecting consumers in vulnerable situations - where we will continue to offer substantial funding for GDNs to partner with each other and third parties to deliver initiatives supporting consumers in vulnerable situations and protecting against carbon monoxide.

1.20 We are also maintaining financial incentives to ensure GDNs remain focused on delivering providing excellent customer service and keeping interruption times down. In the coming years, we may also see increasing numbers of individual disconnections, for which we must ensure the processes are safe, efficient, and do not impact the high-quality service that consumers receive. These areas are considered in Chapter 5 of this document.

System efficiency and long-term value for money

1.21 We will continue to ensure that there is sufficient investment to maintain a safe and reliable gas network, while balancing the cost to consumers of delivering this considering the uncertain future of gas. It is therefore more important than ever to set robust and efficient cost allowances by establishing a robust cost assessment toolkit. Chapter 6 of this document sets out our latest thinking on cost assessment that we will continue to develop for RIIO-GD3.

2. Infrastructure fit for a low-cost transition to net zero

2.1 The energy system will need to change to support the transition to net zero by 2050. Natural gas demand is expected to decline in all future scenarios, but the magnitude, timing and regional distribution of this decline is uncertain.

2.2 We consider it is important to embed flexibility within RIIO-GD3 to manage the uncertainty around the future of gas networks, to enable us to approve funding during the price control as and when the needs case becomes clear. This chapter sets out some GD-specific approaches to managing this uncertainty and enabling investment where it is needed to support the transition to net zero.

2.3 This chapter also sets out how we will require companies to further minimise their impact on the environment, including through reducing the amount of natural gas lost during transportation through the network.

2.4 This chapter should be read alongside the Overview Document, which considers:

- the future of gas in more detail in Chapter [4];
- cross-sector mechanisms to minimise the impact of networks on the environment in Chapter [6]; and
- our approach to managing uncertainty in Chapter [8].

RIIO-GD3 outputs and uncertainty mechanisms

Outputs to minimise networks' impact on the environment

2.5 Our RIIO-GD2 environmental framework focused the GDNs on being more transparent on the environmental impacts of their networks and accountable for the mitigation actions they are taking to reduce these impacts. The core environmental outputs and incentives in RIIO-GD2 were:

- Environmental Action Plan (EAP) and Annual Environmental Report (AER): ensuring that the GDNs take responsibility for the environmental impacts arising from their networks and are more transparent in what they are doing to mitigate these;
- Business Carbon Footprint (BCF) reputational Output Delivery Incentive (ODI-R): setting a common reputational incentive for the TOs on their respective BCF reduction targets;

- Shrinkage Management financial Output Delivery Incentive (ODI-F) and ODI-Rs: incentivising GDNs to reduce shrinkage of gas from their pipe networks; and
- Commercial Fleet Electric Vehicles (EVs) Price Control Deliverable (PCD): to enable GDNs to convert their commercial vehicle fleets to EVs or other zero emission equivalents.

2.6 In this section we set out our decisions on how the GDNs should safeguard the environment in RIIO-GD3, building on an assessment of the RIIO-GD2 mechanisms. Our aims for RIIO-GD3 environmental performance are:

- to mitigate environmental impacts that arise from network activities and increase transparency of GDNs' actions and plans to decarbonise their networks in line with net zero;
- to ensure that the GDNs consider biodiversity and the climate crisis in construction and mitigate environmental impacts prior to construction; and
- improved information sharing and cooperation between the GDNs on environmental initiatives.

2.7 The EAP, AER and BCF mechanisms all apply to at least two of the sectors, so we have described our views on those mechanisms in Chapter [4] of the Overview Document. However, the GDNs have sector specific environmental reporting requirements that they report on through their annual environmental reports (AER) which are set out below.

AER reporting: Biomethane and other low gas connections

SSMC summary

2.8 In RIIO-GD2, the GDNs are required to report on:

- connections data for the reporting year, including a breakdown of the different gases that are included in 'other green gas';
- the green gas connections processes and ongoing issues (including the overarching strategy to address these);
- KPIs in relation to green gas connections;
- ongoing work to improve and standardise low-carbon gas connections methodologies including collaborative efforts across networks; and

- engagement events (past and future) with relevant stakeholders and any learnings of best practice.

2.9 In our SSMC Overview Document (Overview Document) we proposed to strengthen the AER reporting standards for biomethane and other low-carbon gas connections to ensure that the GDNs report consistently.[1]

Summary of consultation responses

2.10 We did not receive any consultation responses on our SSMC proposals for AER reporting on biomethane and other low carbon connections. One stakeholder suggested that the GDNs should also report on biomethane injection rates in response to our draft Business Plan Guidance. It highlighted that pressure constraints can limit injection at certain times in a year and that the GDNs are seeking to address this issue.

SSMD decision and rationale

2.11 We have decided to retain all of the RIIO-GD2 biomethane connections reporting requirements and include injections within the connections reporting requirement in the AERs. This will allow us and stakeholders to see the GDNs' progress on biomethane injections and to understand how and when they face market constraints.

AER reporting: Shrinkage

SSMC summary

2.12 In the RIIO-GD2 AER, GDNs are required to report on:

- the volumes of gas lost from each source of leakage, expressed in GWh;
- the leakage component of the overall shrinkage ODI-R target; and
- annual volumes for the other sources of shrinkage (own use gas and theft), and associated tCO2e volumes.

2.13 In our SSMC, we proposed to strengthen the AER reporting standards for shrinkage to ensure that the GDNs report consistently.[2]

[1] For further information, please see Chapter 6, page 60, paragraph 6.125 of our RIIO-3 Sector Specific Methodology Consultation Overview Document: https://www.ofgem.gov.uk/consultation/riio-3-sector-specific-methodology-gas-distribution-gas-transmission-and-electricity-transmission-sectors

[2] For further information, please see Chapter 6, page 60, paragraph 6.125 of our SSMC Overview Document: https://www.ofgem.gov.uk/consultation/riio-3-sector-specific-methodology-gas-distribution-gas-transmission-and-electricity-transmission-sectors

Summary of consultation responses

2.14 Respondents were broadly supportive of retaining reporting in this area, but suggested that the AER:

- reporting should be assessed and simplified;
- scope of reporting should be widened to report on both GWh as well as tCO2e.; and
- should continue to report modelled shrinkage until observed reporting becomes available.

SSMD decision and rationale

2.15 We have decided that GDNs should continue to use their AER to publicly report on their total shrinkage volumes, but that this reporting should be widened to cover both GWh and tCO2e. This will ensure consistency in what is reported in the RRPs in RIIO-GD3.

2.16 We will require the GDNs to report on modelled measurements of shrinkage in their AERs. Once observed measures of shrinkage become available, GDNs will also be required to report on this alongside the modelled reporting. This will provide a richer source of data for stakeholders.[3]

2.17 The GDNs are required to propose targets and timelines associated with shrinkage reduction activities in their EAPs and to report on their progress against these within their AERs. This will allow us, and wider stakeholders, to monitor the GDNs' progress.

2.18 We have also decided that GDNs should report on pressure management activities and gas conditioning within their AERs. Whilst we have decided to remove the Shrinkage ODI-F (see paragraphs 2.35-2.39), we think that it is important for the GDNs to continue undertaking pressure management and gas conditioning to support shrinkage reductions. The GDNs are required to propose targets for pressure management and the use of gas conditioning within their business plans.

[3] Future rollout of the Digital Platform for Leakage Analytics (DPLA) is discussed below.

AER reporting: Hydrogen blending

SSMC summary

2.19 In our SSMC, we highlighted that hydrogen blending could affect the way the gas network is operated, eg in relation to pressure management, which in turn could impact shrinkage.[4]

2.20 We asked stakeholders to provide evidence of how the implementation of blending could change operational practices and the impact that this could have on the GDNs' ability to manage shrinkage and targets.

Summary of consultation responses

2.21 All the GDNs stated that hydrogen blending would require revisions to their operational practices. They provided examples but noted that the ongoing HyDeploy project will provide more clarity on these.[5]

2.22 In relation to the impact of shrinkage, the majority of GDNs stated that blending of 20% could reduce their methane shrinkage levels by 5-7%. One GDN highlighted that this would need to be accounted for in leakage targets.

2.23 In response to our proposal for the New Large Load Connections Re-opener (see paragraphs 4.181-4.188), a stakeholder suggested that we should require the GDNs to develop common arrangements for hydrogen connections and injections to prevent barriers for producers seeking to operate in multiple network regions.

SSMD decision and rationale

2.24 We have decided to establish a hydrogen blending reporting metric within the AERs. Once government provides further clarity on its expectations for hydrogen blending, we think it will be important for the GDNs to report on hydrogen blending. This is so that we can see their progress and because it could impact their methane shrinkage levels in RIIO-GD3.

2.25 See Chapter 4 of the Overview Document for more detail on our approach to funding costs relating to hydrogen blending, including in relation to operational practices.

[4] Hydrogen Blending into GB Gas Distribution Networks: A consultation to further assess the case for hydrogen blending and lead options for its implementation, if enabled, October 2023: https://www.gov.uk/government/consultations/hydrogen-blending-into-gb-gas-distribution-networks
[5] https://hydeploy.co.uk/

Cadent proposal on a net zero transition coordination incentive

Cadent's proposal

2.26 In Cadent's SSMC response, it proposed a cross-sectoral net zero transition coordination incentive that would reward companies for delivering consumer benefits that require coordination and collaboration to define best practices.

2.27 The proposed outcome areas were:

- the facilitation of biomethane and hydrogen blending resources;
- supporting cross sector resilience;
- supporting climate change adaption by collaborating with other sectors, eg water;
- supporting market and regulatory frameworks for hydrogen (including in relation to hydrogen blending);
- protecting vulnerable consumers to ensure they are not left behind in the transition;
- support whole system national and regional strategic planning, eg interactions with the National Energy System Operator (NESO); and
- co-ordinating digitalisation across sectors.

2.28 It suggested that an independent expert panel could periodically assess the networks' performance in these areas (eg after years 2 and 4 of RIIO-GD3) and administer a reward of up to 0.25% of annual revenue for each assessment.

SSMD decision and rationale

2.29 We have decided not to progress Cadent's proposal. Whilst we agree that the proposed outcome areas could produce consumer benefits, it is unclear how an ODI-F could be calibrated to place a financial value on the benefits that may be provided to consumers. We also consider that some of the outcomes are already accounted for through other mechanisms in RIIO-GD3, and some are business as usual (BAU). For example, we consider it BAU for network companies to support national and regional system planning. Therefore, we will not include an ODI-F against the outcomes areas that Cadent has proposed.

2.30 However, we have considered Cadent's proposals relating to hydrogen blending and think it will be beneficial to include a hydrogen reporting metric within the companies' AERs (see paragraph 2.26-2.28).

Shrinkage management

2.31 Shrinkage is gas lost during its transportation through the network. It is made up of gas leakage, gas used by the network as part of its operations (eg to preheat gas prior to pressure reduction) and gas stolen from the network.

2.32 Reducing shrinkage provides environmental benefits by reducing methane emissions, which account for about 95% of the GDNs' business carbon footprint (BCF).[6] It also benefits consumers through reducing the cost of purchasing replacement gas.

2.33 In our SSMC, we highlighted the difficulties of measuring shrinkage using the GDNs' Shrinkage and Leakage Model (SLM).[7] The main GDN influence on reducing shrinkage is from the replacement of iron pipes, which are prone to leaks, with plastic ones. This work is BAU and funded as part of the repex programme which will continue to drive shrinkage lower during RIIO-GD3 (see Chapter 3). However, there are some activities outside of the core repex work that the GDNs can influence to further reduce shrinkage, eg pressure management and gas conditioning.

2.34 The following section outlines the regulatory mechanisms we will use to encourage the reduction of shrinkage in RIIO-GD3.

Shrinkage ODI-F/Use It or Lost It Allowance (UIOLI)

SSMC summary

2.35 In RIIO-GD2 we set a shrinkage ODI-F to target shrinkage reductions through pressure management and gas conditioning, and to exclude shrinkage reductions resulting from the repex programme.

2.36 In our SSMC, we set out four options to incentivise shrinkage management:[8]

- Option 1: retain the shrinkage ODI-F in its current form.
- Option 2: remove the shrinkage ODI-F and replace it with a UIOLI to fund low materiality activities to reduce shrinkage. We set out an option to

[6] Methane emissions through the leakage of pipes are the sectors biggest BCF, impacting the UK's carbon emissions.
[7] RIIO-3 SSMC, GD Annex, Chapter 2, paragraph 2.11, page 13-15: https://www.ofgem.gov.uk/consultation/riio-3-sector-specific-methodology-gas-distribution-gas-transmission-and-electricity-transmission-sectors
[8] RIIO-3 SSMC, GD annex, Chapter 2, paragraph 2.18, page 16-17: https://www.ofgem.gov.uk/consultation/riio-3-sector-specific-methodology-gas-distribution-gas-transmission-and-electricity-transmission-sectors

include this within the Net Zero and Re-opener Development Fund (NZARD) UIOLI.

- Option 3: implement a penalty only ODI-F based on total shrinkage volumes (ie including shrinkage reduction from repex), alongside baseline funding for specific activities and projects to reduce shrinkage.
- Option 4: combine options 2 (UIOLI) and 3 (a penalty-only ODI-F).

Summary of consultation responses

2.37 The majority of respondents supported option 2, to create a UIOLI allowance, and supported including this within the NZARD UIOLI. One GDN supported retaining the RIIO-GD2 shrinkage ODI-F (with modifications).

2.38 Some stakeholders had suggestions on how a shrinkage UIOLI could be governed. This included the need for governance on the types of projects that could be funded, whether PCDs should be attached to projects, and that the scale of the UIOLI should be decided at Draft Determinations.

2.39 Stakeholders stated concerns with the current RIIO-GD2 ODI-F, with some suggesting that it focuses the GDNs' behaviour on avoiding penalties, rather than leakage reduction, and that it does not encourage innovation. Respondents said that focusing the ODI-F only on pressure management and gas conditioning could prevent investment into other elements of shrinkage reduction eg above ground installation leakage and venting or a move from modelled to observed leakage. Some respondents also said that the complexity of the current ODI-F makes it difficult to distinguish whether rewards reflect strong performances amongst the GDNs.

2.40 If the current ODI-F were to be retained, two respondents suggested that the ODI-F should only focus on system pressure and remove gas conditioning targets, as they said that these can drive negative behaviours to avoid penalties.

2.41 Two GDNs proposed having a shrinkage ODI-F alongside a shrinkage UIOLI. One suggested that the ODI-F should reward GDNs that undertake projects that are above a shrinkage target that controls for the effects of repex programme. The other GDN proposed that the ODI-F could provide a:

- reward or penalty to GDNs five years after spending the UIOLI allowance - based on evidence that investments have brought benefits to consumers;
- reward to incentivise GDNs to achieve milestones for the implementation of an observed measurement. The reward value would reduce as the price control period progresses; or

- reward based on observed (rather than modelled) leakage. The GDN suggested that this ODI-F could be switched on once a GDN has implemented observed measurement to incentivise the GDNs to deliver this at pace.

SSMD decision and rationale

2.42 We have decided to introduce a Shrinkage UIOLI allowance (option 2). This approach was supported by stakeholders and will enable the GDNs to fund projects that emerge during the price control period.

2.43 The Shrinkage UIOLI will be included within the NZARD UIOLI allowance in RIIO-GD3. We think this is appropriate because there is already an established governance process for the NZARD which can be built on for RIIO-GD3. Stakeholders did not indicate that individual shrinkage activities will be material in RIIO-GD3, which we also think makes the NZARD appropriate as it is intended for small net zero projects. We will update the NZARD Governance to enable this ahead of RIIO-GD3. See Chapter 8 of the Overview Document for our NZARD decision, including on the scale of the UIOLI.

2.44 In addition, we agree with the GDNs' proposal to include the ability to fund some shrinkage reduction activities that are currently funded via PCDs in RIIO-GD2 within the UIOLI allowance. We will ensure that the RIIO-GD3 NZARD UIOLI allowance will be able to fund activities including:

- the installation of pressure management equipment;
- the deployment of high-volume gas escapes toolkits and stent bags;
- the rollout of shrinkage related innovation projects funded through the RIIO-GD3 innovation package.

2.45 GDNs will also be able to submit costs and timelines for shrinkage reduction projects that they know they plan to undertake in RIIO-GD3 in their business plans, including for the activities listed above and for the rollout of advanced leakage detection technologies. We will decide whether the shrinkage UIOLI allowance is an appropriate mechanism to fund this work or whether baseline allowances should be provided.

2.46 To streamline RIIO-GD3, we have decided to implement a UIOLI and remove the shrinkage ODI-F. The UIOLI will replace the ODI-F. We note that stakeholders consider the ODI-F to be complicated, does not drive material behaviour change to reduce shrinkage and could prevent useful investments. We still think the ODI-F focuses on the key areas in the GDNs' control, in particular pressure

management. However, on balance, the introduction of a UIOLI will enable greater flexibility for GDNs to fund low materiality projects and support more rapid shrinkage reduction. It also supports greater simplicity in the price control. In addition, we think the Digital Platform for Leakage Analytics (DPLA) will play a crucial role in progressing a move to an observed measure of leakage, allowing the GDNs to mitigate shrinkage further through the use of real time data and leak detection technologies. This could support the introduction on an ODI-F in RIIO-GD4. We have set out how we intend to facilitate the rollout of the DPLA in RIIO-GD3 in paragraphs 2.49-2.51 of this document, and do not think an ODI-F is needed to support this.

Shrinkage ODI-R

SSMC summary

2.47 The RIIO-GD2 shrinkage reputational ODI (ODI-R) requires the GDNs to report on their total annual shrinkage volumes within their annual regulatory reporting packs (RRPs).

2.48 In our SSMC, we set out that there is duplication between the RIIO-GD2 ODI-R and the annual environmental reports (AER). We therefore proposed to remove the shrinkage ODI-R to consolidate the GDNs' reporting requirements and to streamline the price control.[9] We set out proposals for the GDNs to continue to report on their annual shrinkage volumes in the RRPs as part of their AER obligations.

Summary of consultation responses

2.49 The majority of stakeholders agreed with our proposal to remove the shrinkage ODI-R, providing that RIIO-GD2 reporting of total annual shrinkage and leakage volumes will continue to be reported in the AERs.

SSMD decision and rationale

2.50 We have decided to remove the shrinkage ODI-R to remove the duplication between the shrinkage ODI-R and the AER. We will still require the GDNs to report on annual shrinkage volumes through the RRPs to ensure consistency and robustness in data reporting. We have considered additional reporting

[9] RIIO-3 SSMC, GD annex, Chapter 2, paragraph 2.15-2.16 page 15: https://www.ofgem.gov.uk/consultation/riio-3-sector-specific-methodology-gas-distribution-gas-transmission-and-electricity-transmission-sectors

suggestions from stakeholders in this area and have decided to accept all proposals - see paragraphs 2.15 to 2.18 on the AER.

Digital Platform for Leakage Analytics and leak detection technologies

SSMC summary

2.51 During RIIO-GD2, Cadent has received Strategic Innovation Fund (SIF) investment for the DPLA project, which aims to use new technologies eg leak detection mounted vehicles to improve the accuracy of leak detection and measurement. The DPLA seeks to replace the existing SLM to improve shrinkage reporting and to enable the GDNs to optimise their maintenance and repair operations to enable further leakage reductions. However, Cadent does not anticipate that the DPLA will be rolled out before the start of RIIO-GD3.

2.52 In our SSMC, we said that although there is a potential for the DPLA to support shrinkage reductions in the future, we do not think there is enough information, or certainty, on how it would be rolled out to create an incentive linked to it. We did not have a clear understanding of the likely cost of rolling out the DPLA and therefore welcomed evidence on this from the GDNs.

Summary of consultation responses

2.53 The majority of GDNs highlighted difficulties in forecasting costs of the DPLA and leak detection technologies as the project is not mature. However, our expectation is that the GDNs will have sufficient clarity in time for inclusion in the business plans. Many stakeholders also emphasised the importance of flexibility of funding in RIIO-GD3 to allow GDNs to quickly adopt new technologies associated with the DPLA.

2.54 Cadent said that the full DPLA will be completed by February 2026, which would deliver a working platform for a localised network area. However, it may take slightly longer for other GDNs to deploy leakage technologies at scale to support the full deployment of the DPLA.

SSMD decision and rationale

2.55 We have decided to fund the rollout of leak detection technologies and to require the GDNs to provide further details on the rollout of the DPLA in their business plans. Given the response from stakeholders regarding the difficulties in forecasting cost, we continue to think that there is not enough information, or certainty, on how the DPLA could be rolled out to create a new shrinkage incentive linked to it. However, we think the DPLA will provide substantial

benefits, allowing a move from an outdated modelled view of leakage to an observed view of leakage. We expect that observed reporting will help provide enough data to establish a robust incentive in RIIO-GD4.

2.56 As the GDNs are expected to have more information on the forecast costs and timelines of the DPLA shortly, we think that the GDNs should include individual plans for the rollout of the DPLA onto their networks within their business plans. These plans should sit within the EAP and include costs (and the certainty of these), timescales and cost benefit analysis. This will enable us to develop an appropriate mechanism at Draft Determinations to fund the rollout of the DPLA.

2.57 We support the rollout of leak detection technologies. As the availability and use of leak detection technologies can be easily forecasted and could have material costs, we think this could be funded through baseline allowances instead of through the UIOLI. This will allow the GDNs to roll out leak detection technologies quickly onto their networks, as opposed to waiting for the rollout of the DPLA. We expect GDNs to include their rollout plans for leak detection technologies including costs, and the types of leak detection technologies they plan to adopt, within their business plans. These plans should also sit within the EAP and include costs, timescales and cost benefit analysis. We think the use of leak detection technologies in RIIO-GD3 will allow the GDNs to reduce shrinkage as they will be able to detect and repair leaks on their network at a faster rate.

2.58 We also note that the current SLM has not been updated in many years. Potential rollout of the DPLA should not prevent the GDNs from updating the SLM ahead of RIIO-GD3, eg to update modelling assumptions for own use gas and the methodology for profiling shrinkage volumes across the year.

Heat Policy Re-opener

SSMC summary

2.59 The Heat Policy Re-opener enables the GDNs' allowances to be increased or decreased to account for changes in:

- connection charging arrangements for distributed entry connections;
- connection charging arrangements for domestic premises;
- obligations on GDNs to promote the energy efficiency of gas customers; and
- quality and composition of gas.

2.60 In our SSMC, we recognised that uncertainties relating to heat policy would remain during RIIO-GD3, so we proposed to either:

- roll over the RIIO-GD2 heat policy re-opener mechanism to RIIO-GD3; or
- remove heat policy as a separate re-opener mechanism and combine it with one of the net zero-related uncertainty mechanisms (UMs) set out in Chapter 8 of the Overview Document.

2.61 We also proposed that, if the heat policy re-opener is retained, we should remove the trigger relating to energy efficiency, as the UK government is no longer considering imposing energy efficiency responsibilities on GDNs. We also set out that if it is appropriate for RIIO-GD3 to fund network investment or changes in spending as a result of the government decisions on hydrogen heating, then this could be managed through the re-opener.[10]

Summary of consultation responses

2.62 The majority of stakeholders said that the heat policy re-opener should be retained in RIIO-GD3 given its material nature and given that it is the most appropriate mechanism to respond to the government's planned strategic decision on the role of hydrogen in heat decarbonisation in 2026.[11] One GDN supported the re-opener being merged with one of the other net zero UMs. One stakeholder also suggested splitting elements of the re-opener out into separate mechanisms with their own materiality thresholds, eg for decommissioning, disconnections, the government's 2026 decision and spikes in gas prices.

2.63 Two GDNs provided suggestions for the trigger windows: one suggested that the application windows should be removed, and the other suggested that there should either be annual trigger periods or that GDNs should be able to bring forward applications at any time.

2.64 No stakeholders disagreed with our proposal to remove costs associated with energy efficiency from the re-opener.

[10] Chapter 4, paragraph 4.18, page 27 of RIIO-3 SSMC Overview document: https://www.ofgem.gov.uk/sites/default/files/2023-12/RIIO-3%20SSMC%20Overview%20Document.pdf
[11] Hydrogen heating: overview, DESNZ website: https://www.gov.uk/government/publications/hydrogen-heating-overview/hydrogen-heating-overview--2

SSMD decision and rationale

2.65 We have decided to retain the heat policy re-opener as we think it is an appropriate mechanism to manage the ongoing heat policy uncertainty in RIIO-GD3, including in relation to the government's 2026 heat decision. We will continue to work with government to understand the scope of the 2026 decision and to determine whether RIIO is the most appropriate funding mechanism for any resultant costs, or whether other government-led hydrogen funding mechanisms should be used to cover some or all of these costs.

2.66 We will remove the trigger associated with new obligations for the GDNs to promote energy efficiency as we no longer consider this to be an area of uncertainty for the GDNs.

2.67 We will retain the Authority trigger for the re-opener to reduce delays and to allow flexibility in when the re-opener is triggered. However, we have decided to remove the trigger windows for RIIO-3 as we think the authority trigger is appropriate to account for possible policy changes and ensures that we are satisfied with the impact of change in question and whether it should be funded via consumers.

Regional energy strategic planning

SSMC summary

2.68 We recently decided to establish a Regional Energy Strategic Planner (RESP) function.[12] The RESP will provide accountability for regional energy system planning so a whole system approach to investment occurs in electricity and gas distribution to meet national and local net zero ambitions. The NESO will be the delivery body for the RESP and will devolve duties through multiple strategic planning roles across GB. We will be consulting soon on the detailed policy framework for the RESP and the form of the strategic planning output, the regional governance and boundaries. This will include more detail on how the RESP will interact with the GDNs.

[12] Decision on future of local energy institutions and governance, Chapter 3, paragraph 3.1, page 15: https://www.ofgem.gov.uk/publications/decision-future-local-energy-institutions-and-governance

2.69 In our SSMC, we set out proposals to account for RESP recommendations through our Net Zero re-opener.[13] We said that the role of the RESP in relation to gas distribution is likely to be limited as the NESO builds up its capability and while key uncertainties persist. As such, we said that if any GD-related recommendations made by RESP require investment during RIIO-3, these would likely relate to large strategic investments. We therefore said that the net zero re-opener would be the most suitable mechanism to cover these material costs.

Summary of consultation responses

2.70 Most stakeholders supported including RESP recommendations under the Net Zero Re-opener. However, one stakeholder suggested that a separate UM should be designed to address issues of uncertainties associated with the RESP.

2.71 Although most stakeholders agreed with the proposal to use the Net Zero Re-opener, many expressed concerns that only having an Authority trigger could create delays in the GDNs quickly responding to RESP recommendations. One stakeholder suggested that the trigger periods should be in line with RESP publishing timescales and should be within 6-12 months of relevant RESP publications.

2.72 One stakeholder raised concerns about our expectation for the limited role of the RESP in RIIO-GD3. The stakeholder suggested that different parts of the country and local area energy planners have different timescale and targets, which could have a material impact on gas network planning, operation and disconnections.

2.73 In addition, stakeholders asked how the GDNs should engage with the RESP upfront and requested that we set out how the GDNs should include activities associated with the RESP in their business plans.

SSMD decision and rationale

2.74 We have decided to include RESP recommendations within the scope of the Net Zero Re-opener (see Chapter 8 of the Overview Document. Although we do not expect the GDNs to incur immediate or frequent costs, we expect that strategic investments recommended by the RESP will be large and material. We also consider that as the Net Zero Re-opener is Authority triggered, it will allow GDNs to quickly bring forward submission to us because it is not time bound.

[13] Framework Decision core Document, Chapter 3, paragraph 3.29, page 52: https://www.ofgem.gov.uk/publications/decision-frameworks-future-systems-and-network-regulation

2.75 The GDNs should collaborate with the NESO, and other relevant stakeholders, to enable the implementation of the RESP. The GDNs should therefore include costs for RESP coordination and engagement within their business plans.

Removed RIIO-GD2 outputs and uncertainty mechanisms

Commercial Fleet EV PCD

SSMC summary

2.76 In RIIO-GD2, the Commercial Fleet EV PCD provides funding for the GDNs to convert their commercial fleets to EVs or to other zero-emission equivalents.

2.77 We proposed to remove Commercial Fleet EV PCD and to allow GDNs to include EV-related costs within their business plans.

Summary of consultation responses

2.78 Respondents had mixed views on our proposal. The majority agreed with our proposal to remove the PCD and provide funding through baseline allowances. One DNO agreed with removing the PCD but did not think that this area of work should be treated as BAU as it said that it was not applied to RIIO-ED2.

2.79 Two GDNs disagreed with the proposed removal of the PCD. One thought it should be retained to account for uncertainties in this area, eg new batteries and hydrogen vehicles. The other said that the removal of the PCD would create upfront capital expenditure, which may create barriers to the deployment of EVs and would restrict its ability to achieve its EAP.

2.80 A few GDNs stated that supply chain issues amongst vehicle providers have made it difficult for them to deploy EVs in RIIO-GD2. One suggested that we should account for these operational challenges and incurred costs beyond baseline allowances.

SSMD decision and rationale

2.81 We have decided to remove the Commercial Fleet EV PCD in RIIO-GD3. However, we are supportive of the GDNs continuing to convert their commercial fleets to EVs, or other zero emission equivalents, to reduce their carbon emissions.

2.82 We think it appropriate to fund this work through baseline allowances given we think this is a BAU activity. We expect the GDNs to submit, and justify, the unit

costs and the volume of the vehicles they plan to convert in RIIO-GD3 in their business plans.[14]

2.83 The GDNs should also include their conversation targets within their EAP and report on their progress as part of their AER. We acknowledge that market constraints have hindered the GDNs' progress at delivering their RIIO-GD2 EAP commitments. However, we think that reporting in the AER will provide stakeholders with visibility of companies' ambition and progress.

Biomethane Improved Access Rollout PCD (SGN only)

SSMC summary

2.84 The RIIO-GD2 Biomethane Improved Access Rollout PCD enables SGN to roll out biomethane technologies.

2.85 We proposed to remove this PCD in RIIO-GD3 as the work associated with this PCD is due to be completed by the end of RIIO-GD2. However, we said that if SGN or other GDNs want to deliver further work in this area, they can include such initiatives in their business plans.

Summary of consultation responses

2.86 The majority of stakeholders agreed with our proposal to remove the biomethane access rollout PCD. However, most stakeholders disagreed with our proposals to fund this area of work through baseline allowances and suggested that it should be funded under another mechanism, eg through the NZARD UIOLI or the network innovation allowance (NIA).

2.87 One GDN suggested that we need to ensure that bespoke outputs are not delivered by other GDNs as part of their BAU, and are benchmarked separately from other parts of the regression analysis.

SSMD decision and rationale

2.88 We have decided to remove the Biomethane Improved Access Rollout PCD in RIIO-GD3 as the work associated with this PCD is expected to be completed in RIIO-GD2. Additionally, as we set out in Chapter 10 of our Overview Document, PCDs will have a material threshold of £15m in RIIO-3, which this project would not meet.

[14] A dedicated costs and volumes table is included within the companies' Business Plan Data Templates.

2.89 However, we think it is important that the GDNs are able to roll out technologies to facilitate biomethane connections. We have therefore decided that the NIA and NZARD UIOLI should fund activities in this area.[15] The GDNs should use their EAP commitments to consider activities in this area and report on their progress within their AERs to ensure there is accountability for delivery in this area.

2.90 We acknowledge a GDN's point on benchmarking and will make a decision on our cost assessment processes for bespoke outputs in our Draft Determination document.

Remote Pressure Management PCD (SGN only)

SSMC summary

2.91 In RIIO-GD2, SGN has a bespoke PCD to install pressure management equipment at 702 district governors across its Southern network to reduce greenhouse gas emissions from leakage.

2.92 We proposed to remove the PCD as the work should be completed by the end of RIIO-GD2. We set out that if SGN, and other GDNs, want to deliver further work in this area, they may propose costs in their business plans.

Summary of consultation responses

2.93 The majority of stakeholders agreed with the proposed removal of the gas escapes PCD. However, SGN and the SGN ISG suggest that this area of work should be funded under the NZARD and NZASP (if merged). SGN also suggested that the current PCD licence condition should be updated for RIIO-GD3, if funding does not permit this work to be funded under the NZARD and NZASP.

SSMD decision and rational

2.94 We have decided to remove the Remote Pressure Management PCD in RIIO-GD3 as work associated with this project is expected to be completed in RIIO-GD2 therefore the PCD will not be required in RIIO-GD3. In addition, as we set out in Chapter 10 of our Overview Document, PCDs will only fund material areas.

2.95 However, we think it is important that the GDNs continue to undertake shrinkage reduction activities in RIIO-GD3. If the GDNs want to install pressure management equipment in RIIO-GD3, they should submit and justify costs within their business plans. At Draft Determinations, we will decide whether to fund any

[15] See Chapter 4 of the Overview Document.

activities in this area through the shrinkage UIOLI allowance (see paragraph 2.36) or whether to provide baseline allowances. Where the GDNs include proposals in this area, they should set out targets as part of their EAP commitments and report on their progress and how this project has contributed to shrinkage reductions within their AERs.

Gas Escape Reduction PCD (SGN only)

SSMC summary

2.96 In RIIO-GD2, SGN has a bespoke Gas Escape Reduction PCD to facilitate the rollout of RIIO-GD1 innovations to reduce leakage, which included the use of a high-volume gas escapes toolkit and stent bags.

2.97 We suggested that the removal of this PCD as work under this PCD should be completed by the end of RIIO-GD2.[16] We set out that if SGN or any other GDNs wish to continue work in this area, they may propose, and justify costs in their business plans.

Summary of consultation responses

2.98 Most stakeholders agreed with our proposal to remove the gas escapes PCD, excluding SGN. SGN suggested that costs to deploy innovative technologies should be funded under the current PCD (its preferred approach) or through the NZARD UIOLI and NZASP re-opener.

SSMD decision and rationale

2.99 We have decided to remove the Gas Escape Reduction PCD in RIIO-GD3 as work in this area is expected to be completed by the end of RIIO-GD2, therefore a PCD will not be required. In addition, we set out in Chapter 10 of our Overview Document that PCDs will generally only fund areas above £15m.

2.100 However, we think it is important that the GDNs continue to undertake shrinkage reduction activities in RIIO-GD3. If the GDNs want to roll out innovations to reduce leakage, like those funded through this PCD in RIIO-GD2, they should submit and justify costs within their business plans. At Draft Determinations, we will decide whether any activities in this area through should be funded through the shrinkage UIOLI allowance (see paragraph 2.36) or whether to provide

[16] RIIO-2 Final Determinations, SGN annex, Table 22, page 18: https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator

baseline allowances. Where the GDNs include proposals in this area, they should set out targets as part of their EAP commitments and should report on their progress and how this project has contributed to shrinkage reductions within their AERs.

Intermediate Pressure Reconfigurations PCD (SGN only)

SSMC summary

2.101 In RIIO-GD2, Intermediate Pressure Reconfigurations is a bespoke PCD that allows SGN to reduce risks to its Scotland network by replacing and reconfiguring 515 services and 9.32km of steel mains connected to intermediate pressure gas mains. The PCD provides SGN with funding to install 85 small pressure regulating installations and 355 service governors.

2.102 We proposed to remove this PCD as work in this area is expected to be completed by the end of RIIO-GD2.[17] We set out that if SGN, or other GDNs, want to deliver further work in this area, they may propose and justify costs in their business plans.

Summary of consultation responses

2.103 The majority of stakeholders support the proposed removal of the PCD, whilst two GDNs remained neutral. SGN said that we should continue to use PCDs for similar projects.

SSMD decision and rationale

2.104 We will remove the Intermediate Pressure Reconfiguration PCD in RIIO-GD3 as we expect this area to be completed by the end of RIIO-GD2, therefore, the PCD will no longer be required. In addition, we also set out in Chapter 10 of our Overview Document that PCDs will generally only fund areas above £15m.

2.105 However, we think it is important that the GDNs continue to undertake shrinkage reduction activities. If the GDNs want to propose activities like those funded through this PCD in RIIO-GD3, they should submit and justify costs within their business plans. At Draft Determinations, we will decide whether any activities in this area through should be funded through the shrinkage UIOLI allowance (see paragraph 2.36) or whether to provide baseline allowances. Where the GDNs include proposals in this area, they should set out targets as part of their EAP

[17] RIIO-2 FDs, SGN annex, Table 23, page 21: RIIO-2 Final Determinations for Transmission and Gas Distribution network companies and the Electricity System Operator | Ofgem

commitments and report on their progress and how this project has contributed to shrinkage reductions within their AERs.

HyNet Front End Engineering Design (FEED) PCD (Cadent only)

SSMC summary

2.106 The RIIO-GD2 HyNet FEED bespoke PCD has provided Cadent with funding to undertake a FEED study for an 85km hydrogen pipeline within the HyNet industrial cluster.

2.107 We proposed to remove this PCD as all the associated work will be completed within the RIIO-GD2 period.

Summary of consultation responses

2.108 GDNs broadly supported the proposed removal of HyNet FEED PCD. Two GDNs suggested that a PCD for similar FEED studies could be replicated in RIIO-GD3.

SSMD decision and rationale

2.109 We have decided to remove the HyNet FEED PCD in RIIO-GD3. We have considered the GDNs' suggestions for similar PCDs in RIIO-3, however, as set out in Chapter 4 of the Overview Document, development expenditure (devex) related to hydrogen transport infrastructure (including FEED studies), will not be funded in RIIO-3. Costs for devex may be recoverable from the Hydrogen Transport Business Model (HTBM), so this approach will prevent the duplication of funding with the HTBM.

3. Secure and resilient supplies

3.1 Network companies need to continue to deliver a safe and resilient network that is also efficient and responsive to change. This chapter sets out how we will enable this in RIIO-GD3. We expect investment in this area to remain the predominant driver of costs in RIIO-GD3, with a large part of this relating to the replacement of old and deteriorating assets.

3.2 This chapter should be read in parallel with Chapter [6] of the Overview Document which describes our RIIO-3 approach to:

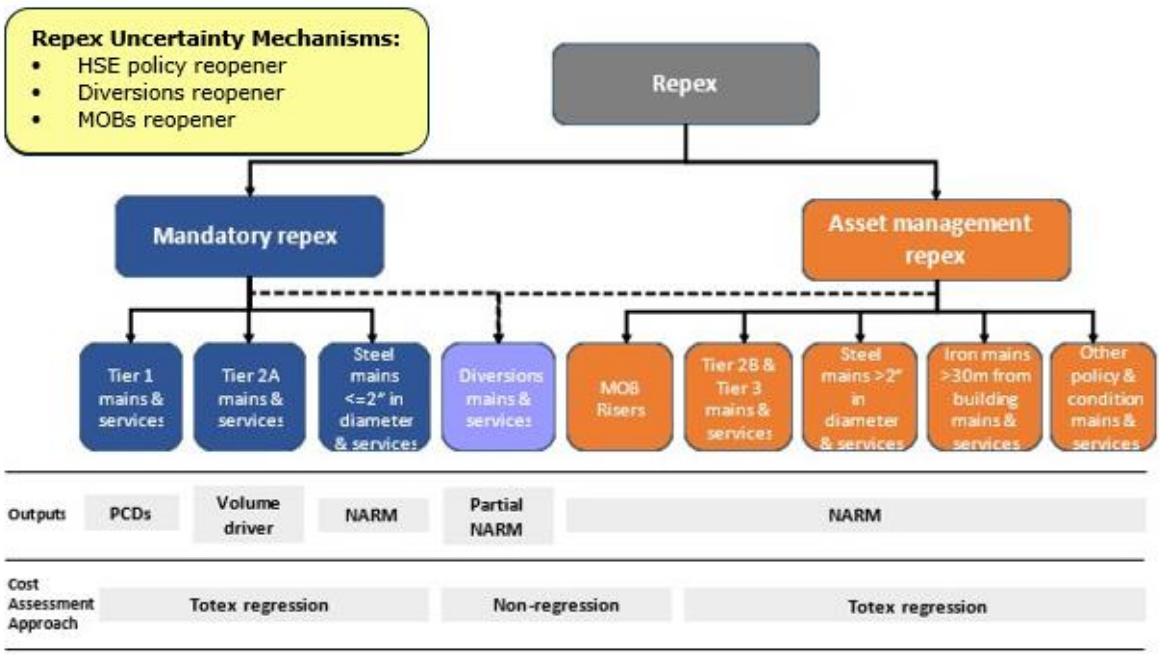
- the Network Asset Risk Metric (NARM);
- physical security;
- cyber security; and
- climate resilience.

RIIO-GD3 outputs and uncertainty mechanisms

Repex

3.3 Repex refers to the long-term programme to replace old and deteriorating mains, services and risers. Figure 1 summarises our approach to outputs and cost assessment for repex in RIIO-GD3. We discuss the repex PCDs and UMs in the following section. The Tier 1 stubs re-opener, which we have decided to remove, is discussed in paragraphs 3.57-3.61.

Figure 1: Overview of our approach to repex in RIIO-GD3



3.4 Typically, iron or steel gas mains and services are replaced with plastic pipes. In addition to protecting health and safety, repex provides significant environmental and operational benefits through reducing methane leakage from the network.

3.5 Health and Safety Executive (HSE) requirements are the primary driver of repex. In RIIO-GD2, over 70% of repex spend is driven by the HSE's Iron Mains Risk Reduction Programme (IMRRP), which requires the GDNs to manage the safety risk of iron mains that are within 30 metres of a building.[18] Depending on their size, HSE's current IMRRP enforcement policy specifies that these iron mains must be managed either through decommissioning, remediation[19] or condition monitoring,[20] as summarised in Table 1 below.

[18] HSE, Iron Mains Risk Reduction: https://www.hse.gov.uk/gas/supply/mainsreplacement/index.htm

[19] For larger diameter mains, it may be possible for GDNs to undertake remediation action (ie internally sealing pipe joints) that prolongs the operating life of a pipe over the medium term (ie 10-20 years). Typically, these remediation actions are less costly than full replacement, but offer shorter operating lives.

[20] Tier 2 pipes scoring above a risk-action threshold and Tier 3 pipes are subject to condition monitoring. Where pipes are found not to be in an efficient state, in efficient working order and in good repair, the GDNs should act to remedy this.

Table 1: Overview of IMRRP iron mains categories

Tier	**Characteristics of Mains**	**Action**
Tier 1	Less than or equal to 8 inches in diameter.	Must be decommissioned by 2032.
Tier 2A	Greater than 8 inches to less than 18 inches in diameter, which are below a risk-action threshold.[21]	Must be decommissioned or remediated over the period of the GDN's Approved Programme.
Tier 2B	Greater than 8 inches to less than 18 inches in diameter, which are below a risk-action threshold.	Mains are subject to condition monitoring. Decommissioning can be funded if supported by cost-benefit analysis (CBA).
Tier 3	Equal to or greater than 18 inches in diameter.	Mains are subject to condition monitoring. Decommissioning can be funded if supported by CBA.

3.6 We also consider the replacement of non-polyethylene (non-PE) services, steel pipes less than 2 inches in diameter and medium pressure ductile iron (MPDI) mains to be mandatory.[22]

3.7 The GDNs must also manage the risk of their assets that are not included within the HSE's mandatory programme. Therefore, the remaining repex spend is for asset management activities. This includes replacement of Tier 2B and Tier 3 mains, as well as the replacement of risers and mains of other materials as required. Non-mandatory repex is covered by NARM and is justified through CBA, considering safety, operational and environmental benefits. Our approach to NARM is discussed in Chapter 6 of the Overview Document.

[21] The risk-action threshold is agreed between HSE and each GDN individually. It is a risk score for an individual main, above which the GDN is expected to take appropriate action to make the pipe safe, either through remediation, decommissioning and/or replacement. The score is measured by the Mains Risk Prioritisation System (MRPS) methodology and estimates the probability of the mains pipe causing an explosion incident, per kilometre, per annum. The MRPS considers factors such as the fracture history of the pipe, the fracture history of other mains within the same area, the likelihood that gas will enter a building, the operating pressure of the pipe and the diameter of the main.

[22] The HSE expects that GDNs will replace non-PE services and steel pipes <2 inches in diameter when they encounter them, and the GDNs have 12 months to remove any remaining MPDI mains they encounter. The GDNs may encounter these assets through undertaking mains replacement activity or for other reasons, such as after a reported gas escape. See, for example: https://www.hse.gov.uk/foi/internalops/og/og-00019.htm

Joint review of the IMRRP with DESNZ, HSE and Ofgem

SSMC summary

3.8 Last year, DESNZ, the HSE and Ofgem undertook a joint review of the IMRRP from safety, environmental, cost and effectiveness perspectives.

3.9 In our SSMC we shared our initial findings from the review: that the IMRRP in its current form delivers safety, environmental and operational benefits, provides value for money and should be continued in RIIO-3.[23] Following this, the HSE conducted a further technical review of their IMRRP Enforcement Policy.

Summary of consultation responses

3.10 Stakeholders generally agreed with the benefits of repex outlined in our SSMC. Most stakeholders think the repex programme is working well and delivering value for money for GB consumers. Some GDNs commented that further work could be done to assess how Tier 2 and 3 iron mains and steel assets are prioritised. Two stakeholders took a more neutral position and emphasised that the costs of the programme must be carefully balanced with the benefits given the uncertain future of gas.

3.11 The GDNs cited that growing cost pressures stemming from economic factors, supply chain issues, increased complexity, streetworks and labour constraints may warrant changes to the way data is reported and cost assessment is conducted. One GDN cautioned that the business plans should be carefully examined to ensure that GDNs do not receive additional funding for work that was already funded through previous price controls.

SSMD decision and rationale

3.12 We have decided to continue providing funding through RIIO-GD3 to enable the GDNs to meet their safety obligations. The HSE, which sets the need for this investment, considers that the IMRRP is still needed, and we think that the programme delivers benefits to consumers. DESNZ is supportive of this decision, recognising the primary safety benefits of the programme and the contribution this programme makes towards reducing emissions and operational costs.

3.13 While we need to proceed with repex investment under the current policy framework, our range of UMs (including the HSE Policy Re-opener and Heat Policy

[23] RIIO-3 SSMC, GD Annex, paragraphs 3.5 and 3.11 - 3.14: https://www.ofgem.gov.uk/consultation/riio-3-sector-specific-methodology-gas-distribution-gas-transmission-and-electricity-transmission-sectors

Re-opener) will allow us to adjust funding should strategic changes occur during RIIO-GD3 which affect the future of the GD network. This could include changes in government or HSE policy, or RESP recommendations relating to the repex programme.

3.14 The HSE has also conducted a separate technical review to consider whether changes should be made to its IMRRP Enforcement Policy ahead of RIIO-GD3 so that it remains fit for purpose. The preliminary findings of the HSE's review are that changes to the Tier 1 workloads and timelines are not needed. However, changes in relation to larger diameter pipes may be needed, to ensure that the risk presented by these pipes is appropriately managed as they get older. For example, one option is to revise how the risk-action threshold is used to identify pipes requiring appropriate attention. The HSE is also exploring how new technologies (such as advanced leakage detection and inspection techniques) can be used to improve condition monitoring. We will continue to work with the HSE to support their technical review and consider whether amending our reporting requirements can improve transparency and data quality.

3.15 The HSE intends to make a final decision on changes to its IMRRP Enforcement Policy in the autumn. We expect that any resultant changes to the repex programme due to HSE changes to its Enforcement Policy can be reflected in the business plans and funded through the regulatory mechanisms set out in the rest of this section. However, we will examine the final outcome of the HSE's review and will consider whether to amend our approach at Draft Determinations.

3.16 As part of our business plan assessment, we will consider what payback cut-off period to apply to asset management investment. This could be shorter than in RIIO-GD2 to reflect uncertainty in the future of gas. This will ensure that the benefits of repex are carefully balanced with the costs. More broadly as part of our business plan assessment, we will also look at other cost assessment considerations, such as unit costs, benchmarking, and funding for activities in past price control periods.

HSE Policy Re-opener

SSMC summary

3.17 The HSE Policy Re-opener allows flexibility to respond to significant changes to HSE policy that materially impact on output targets, workload volumes or cost allowances. In RIIO-GD2, it includes two triggers:

- Trigger 1: changes to the GDNs' costs to deliver repex related licensed activity due to changes to a GDN's Approved Programme or HSE policy or legislation underpinning the repex programme; and
- Trigger 2: material changes to the GDNs' emergency and repair costs relating to new legislation or changes to HSE policy regarding excessive working hours and shift worker fatigue.

3.18 In our SSMC, we proposed to retain the HSE Policy Re-opener. However, we proposed to remove Trigger 2 because we do not anticipate further changes to HSE policy relating to excessive hours or worker fatigue and GDNs to have sufficient knowledge to include the related costs in their business plans.

Summary of consultation responses

3.19 All GDNs supported the proposal to retain the HSE Policy Re-opener. However, while some GDNs agreed that further HSE policy changes relating to excessive hours and worker fatigue are unlikely, all GDNs considered that the scope of the re-opener should be made more flexible to account for other unforeseen policy requirements.

SSMD decision and rationale

3.20 We have decided to retain the re-opener in RIIO-GD3. We will remove Trigger 2 since we no longer anticipate further changes to HSE policy relating to excessive working hours or worker fatigue. We will retain Trigger 1 for changes to HSE policy or legislation surrounding repex-related licensed activity. This includes, but is not limited to, the IMRRP. While some stakeholders requested an expansion of the re-opener, we think the current scope of Trigger 1 is sufficiently broad to ensure that the GDNs can fund essential repair and replacement work should there be any material changes to HSE policy impacting the repex programme.

Tier 1 Mains Decommissioned PCD

SSMC summary

3.21 Tier 1 iron mains decommissioning is mandated by HSE and forms the majority of repex workloads and costs for the GDNs.

3.22 The Tier 1 Mains Decommissioned PCD was implemented in RIIO-GD2 to fund this work. The PCD provides the GDNs with flexibility to manage the Tier 1 repex programme efficiently, while ensuring consumers only pay for workloads that are delivered.

3.23 In our SSMC, we proposed to continue the RIIO-GD2 approach to:

- use four diameter bands (≤3", 4"-5", 6"-7", 8") as the Workload Activities for this PCD; and
- include an Allowance Adjustment Mechanism to adjust allowances at closeout to reflect both the Outturn Workload (the total workload volume to be delivered by the end of RIIO-GD2) and the Outturn Workload Mix (the final delivered mix of workload activities within the Outturn Workload at the end of RIIO-GD2) based on ex ante unit costs.[24]

Summary of consultation responses

3.24 Responses to this proposal were mixed. Most GDNs agreed that the PCD is generally working well. However, the GDNs proposed modifications to it, including removing the 3% upward adjustment collar, or replacing the PCD with a volume driver to enable additional funding for workloads beyond any RIIO-GD3 target. One GDN commented that there is low risk of over delivery in this area because the IMRRP Tier 1 mains workload is largely fixed, except for dynamic growth.[25] Another GDN stated that unit rates in PCDs should be examined to avoid conflating inefficiency with regional differences.

3.25 One GDN strongly disagreed with our SSMC position that no issues had been identified with the PCD and said that significant challenges in the efficient delivery of repex existed due to increased complexity of work. It cited concerns with the PCD's design and called for significant reassessment of the cost assessment methodology to ensure suitable allowances are provided to enable it to deliver its HSE mandated workloads.

SSMD decision and rationale

3.26 We have decided to retain this PCD in RIIO-GD3. Having reviewed the concerns raised by the GDNs regarding cost pressures, we will consider at Draft Determinations whether to slightly increase the cap of the upward Allowance Adjustment Mechanism above 3%. This could enable flexibility to support delivery of the IMRRP Tier 1 programme by 2032. We will not remove the upward Allowance Adjustment Mechanism because it is needed to protect consumers from inefficient overspend. We also think that a PCD, rather than a volume driver,

[24] Any upward adjustment is restricted to 3% of the value of the Baseline Cost Allowance, with any overspend beyond this going through the Totex Incentive Mechanism (see Chapter 7 of the Overview Document). There is no lower limit on adjustments to the Baseline Cost Allowances, as customers should not pay for workloads that the GDNs do not deliver.
[25] As an example, IMRRP-driven Tier 1 mains workloads would increase if a building were constructed within 30 metres of a Tier 1 iron main that was not previously near any buildings.

remains the appropriate mechanism because the workload volumes are relatively well known.

3.27 Our view is that the PCD is working well, and this view is generally supported by three GDNs. We therefore do not find the suggestion by one GDN that the mechanism presents challenges in the efficient delivery of Tier 1 mains repex workloads persuasive, particularly as the 30-year IMRRP enters its final years. However, we will carefully review the proposed costs and justifications when we assess the business plans. This will include looking at detailed cost assessment points raised by GDNs in how we set the unit costs. We discuss our Cost Assessment approach in more detail in Chapter 5.

Tier 1 Services PCD

SSMC summary

3.28 This PCD was established in RIIO-GD2 to fund services interventions associated with Tier 1 mains decommissioning activities. It provides clarity on the target to be delivered in RIIO-GD2 and uses an Allowance Adjustment Mechanism (capped at 10% above the target) to ensure that costs reflect what is delivered.

3.29 In our SSMC, we proposed to continue this approach in RIIO-GD3.

Summary of consultation responses

3.30 Most GDNs said the PCD works well, although two GDNs suggested replacing it with a volume driver. Some GDNs proposed modifications to the PCD, including examining unit rates to avoid conflating inefficiencies with regional differences, establishing separate unit rates for longer services, and amending the cost benchmarking process. Two GDNs also suggested removing caps and collars to reduce the risk that GDNs will be underfunded to deliver mandatory workloads.

SSMD decision and rationale

3.31 We have decided to retain this PCD in RIIO-GD3. We note the cost concerns raised by the GDNs. We will consider at our Draft Determinations whether to slightly increase the cap of the upward Allowance Adjustment Mechanism above 10% if we determine further flexibility is needed to support the delivery of the IMRRP Tier 1 programme by 2032. We will not, however, remove the upward Allowance Adjustment Mechanism because it protects consumers from inefficient overspend. We recognise that the volumes of Tier 1 services are more variable than Tier 1 mains workloads, which is accounted for in the greater flexibility and size of the Allowance Adjustment Mechanism for services compared to mains.

However, because services volumes are well understood, we will retain the PCD rather than establish a volume driver. We will carefully review the proposed costs and justifications when we assess the business plans, and we will consider whether a separate rate for longer services is warranted.

Tier 2A Mains and Services Replacement Volume Driver

SSMC summary

3.32 The volume driver was established in RIIO-GD2 to fund mains replacement for Tier 2A mains and associated services. Volumes of Tier 2A work are uncertain due to the nature of risk scores, so this mechanism adjusts allowances based on the actual workloads delivered.

3.33 In our SSMC, we proposed continuing this mechanism in RIIO-GD3.

Summary of consultation responses

3.34 All responses supported continuing the volume driver, although one GDN suggested that Tier 2A workloads could be funded though baseline allowances given their low materiality. Some GDNs commented that unit rates must be carefully considered.

SSMD decision and rationale

3.35 We have decided to retain the volume driver to manage volume uncertainty. As discussed in paragraphs 3.14-3.15, the HSE is still considering making changes to the Tier 2 programme as part of the review of its IMRRP Enforcement Policy. We will consider if any changes are required once the HSE has made its final decision. We will review the proposed unit rates as part of our business plan assessment.

London Medium Pressure PCD (Cadent North London only)

SSMC summary

3.36 The London Medium Pressure PCD holds Cadent's North London network to account for delivering specific sections of its London Medium Pressure (LMP) project during the price control. The LMP project involves replacing large diameter, medium pressure iron mains in central London and is expected to continue until 2031.

3.37 The PCD in RIIO-GD2 allocates baseline funding for the project,[26] with the expectation that Cadent will prioritise replacement of the highest risk medium pressure iron mains. Cadent reports on this PCD through an independently audited engineering report confirming the completion of each section of the project, as well as through the annual RRPs.

Summary of consultation responses

3.38 Respondents were supportive of retaining this PCD in RIIO-GD3. Cadent suggested that the scope of the PCD should be expanded to include additional work. Another GDN commented that it anticipates submitting a similar PCD in RIIO-GD3 and that having visibility of the LMP project progress would be beneficial for future project planning.

SSMD decision and rationale

3.39 We have decided to retain this PCD in RIIO-GD3, as the project is ongoing until 2031. We will review proposals for any new projects as part of the business plans assessment and will consider their need and benefits in the light of an uncertain future of gas.

3.40 We note the comment on the benefits of having greater visibility of the LMP project progress to help planning. We will explore routes to share additional relevant information alongside our next RIIO Annual Report.

Diversions and Loss of Development Claims Re-opener

SSMC summary

3.41 Pipeline diversions occur when the GDNs are required to move and re-route sections of their networks. Diversions are usually driven by third parties and the costs are mostly rechargeable to the third party. However, in some cases, the GDNs are unable to recover all, or part, of the costs.

3.42 The RIIO-GD2 Diversions and Loss of Development Claims Re-opener enables GDNs to recover costs for:

- non-rechargeable costs related to pipeline diversions at any pressure tier;
- settling claims brought by landowners whose ability to develop their property is curtailed by the presence of gas pipelines; and

[26] The baseline funding is £46.69m (2018/19 price base) in RIIO-GD2.

- rectifying damages to pipelines from soil erosion as a result of extreme weather events.

3.43 In our SSMC, we proposed to retain the re-opener in RIIO-GD3 as we thought that the GDNs would continue to face uncertainties in costs associated with diverting and rerouting the network. We welcomed views on the scope of the re-opener and on whether uncertainties in costs would remain in RIIO-GD3.

3.44 In May 2024, we decided to modify the scope of the re-opener to include work needed due to environmental factors that are outside of the GDNs' control, eg landslips due to extreme weather events.[27]

Summary of consultation responses

3.45 All respondents agreed with our proposal to retain the Diversions and Loss of Development Claims Re-opener in RIIO-GD3. They said that costs will remain uncertain for all GDNs due to uncertain workloads in this area.

3.46 Two GDNs supported our recent decision to widen the scope of this re-opener to include work needed due to environmental factors outside of their control. They suggested that changes made under this licence modification should be retained in RIIO-GD3. However, two GDNs thought that work needed due to environment factors could be recovered through the Resilience Re-opener (see Chapter 8 of the Overview Document) in RIIO-3.

SSMD decision and rationale

3.47 We have decided to retain this re-opener, including retaining the widened scope for work needed due to environment factors outside of the GDNs' control. Retaining this re-opener will ensure that RIIO-GD3 can respond to uncertainties in cost associated with diverting and rerouting the network at the time of setting the price control.

3.48 We do not think it is appropriate to include work needed due to environment factors such as landslips within the Resilience Re-opener, as suggested by two GDNs, as the intent of this re-opener is to enable RIIO-3 to adapt to changing resilience requirements from government or NESO, rather than environmental events.

[27] For further information please see, Decision on a proposal to modify Special Condition 3.20 of the Gas Transporter Licence held by the Gas Distribution Network: https://www.ofgem.gov.uk/decision/decision-proposal-modify-special-condition-320-gas-transporter-licence-held-gas-distribution-networks.

Emergency response time Licence Obligation (LO)

3.49 The GDNs must attend unplanned gas escapes quickly to ensure their networks are safe. The Gas Safety (Management) Regulations 1996 (GSMR) require the GDNs to attend gas escapes as soon as it is reasonably practicable and to prevent the gas escaping within 12 hours.[28]

3.50 In addition to the GSMR requirement, we set a complementary minimum performance standard in the licence that the GDNs must respond to a minimum of 97% of reported gas escapes within one hour for uncontrolled escapes and within two hours for controlled escapes.[29]

SSMC summary

3.51 We observed that an annual performance standard could smooth disparities between higher and lower performance at different times of the year. Thus, we considered modifying the 97% minimum performance standard to a monthly or quarterly basis, rather than having it on an annual basis.

Summary of consultation responses

3.52 All GDNs disagreed with modifying the minimum performance standard to a monthly or quarterly basis and supported the retention of an annual standard. Two GDNs said that this modification would not address the root causes of monthly performance variation. Some GDNs and an ISG also stated that they do not perceive their performance to be an area of customer concern so the increased costs and resources needed to change the standard may not be warranted. All GDNs proposed expanding reporting requirements to provide monthly performance data through the RRPs.

3.53 A consumer group supported changing to a monthly or quarterly standard and suggested that this approach could be considered for other performance metrics with annual targets.

SSMD decision and rationale

3.54 We have decided to retain the LO in its current form, preserving the annual minimum performance target. However, we will increase reporting requirements.

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[28] Regulation 7(4) of the Gas Safety (Management) Regulations 1996: https://www.legislation.gov.uk/uksi/1996/551/contents/made

[29] In RIIO-GD2, the LO was modified to clarify that those attending gas escapes must have sufficient training to deal with the situation competently and the GDN must be able to demonstrate this.

In addition to the existing annual reporting, we will require GDNs to report monthly performance and workload volumes in the annual RRPs for response times to controlled and uncontrolled escapes. We will publish monthly and annual data in our RIIO Annual Report to provide consumers with greater visibility of GDN performance over the year. We will also require the GDNs to proactively provide us with a detailed explanation if their performance falls below 97% in a month.

3.55 Gathering this data will enable us to identify any trends or patterns in performance. This will allow us to determine in the future, whether any changes to the LO are required to ensure safety objectives are adequately supported.

3.56 We also want to understand how the GDNs ensure they meet their HSE safety obligations, or where they go above and beyond these. This should be evidenced as part of their business plans, including the impact on emergency and repair operational costs.

Removed RIIO-GD2 outputs and uncertainty mechanisms

Tier 1 Iron Stubs Re-opener

SSMC summary

3.57 Tier 1 iron stubs are short lengths[30] of Tier 1 iron mains attached to larger diameter parent mains.[31] We introduced the Tier 1 iron stubs re-opener in RIIO-GD2 as there was uncertainty around the workloads for decommissioning stubs.

3.58 The GDNs have gathered information on costs associated with Tier 1 stubs activities in RIIO-GD2 so we think there is now more certainty in this area. Our SSMC therefore proposed to remove this re-opener in RIIO-GD3 and instead factor costs for Tier 1 stubs into baseline allowances.

[30] Usually up to 3m in length, although definitions of a stub vary between GDNs.
[31] Prior to RIIO-GD1, the IMRRP required the GDNs to decommission all iron mains regardless of diameter. Stubs were created when the GDNs replaced a Tier 1 main but left a short section connected to the larger diameter parent main, with the intention of decommissioning it when replacing the parent main later. Under the current IMRRP, stubs joined to a Tier 2 or Tier 3 parent main are not considered Tier 1 pipes, providing they do not exceed a specified maximum length. Stubs may need to be addressed individually if replacement of the parent main is not economically justified through CBA, but replacement of the stub itself is warranted.

Summary of consultation responses

3.59 Stakeholders generally agreed that the re-opener could be removed and that costs associated with Tier 1 stubs activities could be rolled into baseline allowances.

3.60 Some stakeholders made suggestions to facilitate this change. Two GDNs raised concerns that the cost base might not be sufficiently robust for benchmarking purposes and that unit costs should be reviewed to determine whether a technical assessment would be preferrable. Another GDN commented that any HSE policy changes impacting this area could be accommodated through an HSE policy re-opener.

SSMD decision and rationale

3.61 We have decided to remove the re-opener because we think the costs are now sufficiently well understood. We will consider establishing a PCD for Tier 1 iron stubs based on business plan proposals, depending on the materiality of this workload. If we determine that the volumes and costs are relatively certain and the materiality is low, then we may alternatively decide to fund these activities through baseline allowances only. We will consider at Draft Determinations whether a separate technical assessment on unit costs is required.

Capital Projects PCD

SSMC summary

3.62 In RIIO-GD2, we established the Capital Projects PCD to provide funding for discrete capex investment projects costing more than £5m each and to ensure that they are delivered during RIIO-GD2.

3.63 We proposed to remove this PCD in our SSMC as the projects that fall under this PCD are expected to be completed by 31 March 2026.[32]

Summary of consultation responses

3.64 Most stakeholders agreed with our proposal to remove the Capital Projects PCD, but views differed on how similar projects could be funded in RIIO-GD3. One GDN supported funding work under baseline allowances, whereas several GDNs said that a PCD may be required in RIIO-GD3 for large and atypical projects. One GDN

[32] SSMC-GD annex, Chapter 3, page 36, paragraph 3.50: https://www.ofgem.gov.uk/sites/default/files/2023-12/RIIO-3%20SSMC%20GD%20Annex.pdf

said that the PCD provides transparency to customers that projects will be delivered on time. The GDN also suggested that the PCD is merged with the Unit Cost of Risk under NARM.

SSMD decision and rationale

3.65 We have decided to remove the existing Capital Projects PCD in RIIO-GD3 as we expect projects that are funded under this PCD to be completed by the end of RIIO-GD2.

3.66 However, we welcome the GDNs to propose and justify costs for capital projects that they plan to undertake in RIIO-GD3 through their business plans. We will consider whether a PCD, or an alternative mechanism, is required in RIIO-GD3 based on our assessment of the business plan proposals.

Gas Holder Demolitions PCD (NGN and WWU only)

SSMC summary

3.67 We funded a phased demolition of gas holders, once used to store town gas, in RIIO-GD1 due to a decline in usage. NGN and WWU had remaining gas holders on their network at the start of RIIO-GD2, so a PCD was established to ensure demolitions by March 2029.[33]

3.68 We proposed to remove this PCD as NGN and WWU confirmed the gas holder demolitions would be complete by the end of RIIO-GD2.

Summary of consultation responses

3.69 Stakeholders supported our proposal to remove the Gas Holder Demolitions PCD. However, two GDNs highlighted that baseline allowances should be available for ongoing maintenance of remaining gas holders, eg to maintain and remediate land, to remove secondary infrastructure and to maintain listed gas holders.

SSMD decision and rationale

3.70 We will remove the Gas Holder Demolitions PCD in RIIO-3 as NGN and WWU have indicated that their gas holders will be demolished by the end of RIIO-GD2. The GDNs may propose costs for ongoing maintenance of remaining listed gas holders and removal of infrastructures from sites in their business plans.

[33] SGN and Cadent transferred their non-listed gas holders to non-regulated companies in RIIO-GD1, so did not need further funding for gas holder demolitions in RIIO-GD2.

Multiple Occupancy Buildings (MOBs) Safety Re-opener

SSMC summary

3.71 The MOBs Safety Re-opener was established in RIIO-2 to enable the GDNs to respond to any new safety standards imposed on MOBs in response to the Hackitt review.[34] Work under the re-opener included safety-related maintenance, repairs, and surveys for medium-rise MOBs between three and five floors.

3.72 We proposed to remove the re-opener, as the GDNs will no longer face uncertainties relating to the costs of responding to new safety standards as the Hackitt review inquiry has concluded. We proposed that GDNs may include associated costs in their business plans.

Summary of consultation responses

3.73 Three GDNs disagreed with our proposals to remove the MOB Safety Re-opener. They noted uncertainties around their MOB safety requirements and remedial actions, and that these will continue into RIIO-GD3. For example, they said that HSE is considering if current safety arrangements for the highest MOBs should be extended to all MOBs. One GDN said that the re-opener should remain in place until there is more clarity on phase 2 of the Grenfell Tower Inquiry.[35]

3.74 While the majority disagreed with removing the re-opener, several GDNs recognised that the current RIIO-GD2 re-opener may not be appropriate for RIIO-GD3. They stated it is restrictive in scope as it only applies to high-risk buildings, buildings of 3-5 storeys and above 18 metres. They provided alternative suggestions including a new MOB safety re-opener for RIIO-GD3 or potentially use of the HSE Policy Re-opener.

SSMD decision and rationale

3.75 We have decided to remove the re-opener in RIIO-GD3 as it no longer remains appropriate.

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[34] Following the Grenfell Tower tragedy, an independent review into the regulation of high-rise residential buildings and fire safety was commissioned by the UK government (the 'Hackitt Review'). Reforms in this area have now come to end. For further information please see the Building Safety Programme: Building Safety Programme - GOV.UK (www.gov.uk).

[35] Phase 2 of the Grenfell Tower Inquiry is assessing the causes of the tragedy, including the condition of the tower, which enabled a fire to spread in the way that was identified in Phase 1 of the inquiry. For further information please see the Grenfell Tower Inquiry: About | Grenfell Tower Inquiry

3.76 We have considered stakeholders feedback, but do not have enough information to establish whether a new mechanism or baseline funding is appropriate for RIIO-GD3. As there are plans to publish the Grenfell Inquiry Phase 2 report soon,[36] we expect the GDNs to have more clarity on the outcomes and expectations ahead of submitting their business plans. Therefore, the GDNs may propose costs in their business plans and explain if there are uncertainties remaining. We will consider this information to establish the appropriate funding mechanism.

3.77 In addition, the GDNs did not provide evidence of the timescales of potential HSE policy changes relating to MOBs and how this could impact them in RIIO-GD3. GDNs should provide an explanation in their business plans of the challenges and costs that they may face as a result of HSE policy changes relating to MOBs.

Job Completion Lead-time Including Re-instatement ODI-R (NGN only)

SSMC summary

3.78 The RIIO-GD2 job completion time ODI-R is a bespoke incentive for NGN to reduce the time between customers paying for a standard connection service (or alteration) and NGN completing areas of work. The ODI-R focuses on achieving faster connections to improve customer satisfaction.

3.79 We proposed to remove this PCD as NGN is outperforming its RIIO-GD2 targets and we consider this performance can now become BAU for NGN. We also said that we expect that the connections customer satisfaction survey will continue to incentivise performance in this area.

Summary of consultation responses

3.80 Stakeholders agreed with our proposals to remove the ODI-R. A consumer group suggested that we should set out whether the GDNs are expected to adopt the standard delivered by the ODI-R in RIIO-GD3.

SSMD decision and rationale

3.81 We have decided to remove NGN's bespoke Job Completion Lead-time ODI-R in RIIO-GD3. We think that it is important for the GDNs to ensure consumers do not

[36] For further information, please see Grenfell Tower inquiry: https://www.grenfelltowerinquiry.org.uk/news/april-2024-newsletter

experience prolonged connection or alteration times in RIIO-GD3. We expect all GDNs to deliver a good level of service for connection and alteration times as BAU and consider that this will be incentivised through their connections customer satisfaction survey and Guaranteed Standards of Performance (GSOPs) in RIIO-GD3, as discussed in Chapter 4.

4. High quality of service from regulated firms

4.1 This chapter sets out our approach to maintaining a high quality of service at a reasonable cost in RIIO-GD3. This includes how we will ensure that the GDNs are supporting and protecting consumers in vulnerable situations, providing excellent customer service, and continuing to keep unplanned interruption times down.

RIIO-GD3 outputs and uncertainty mechanisms

Vulnerability

4.2 Supporting and protecting consumers in vulnerable situations is a priority for us, particularly given the cumulative impacts of the COVID-19 pandemic, the continuing cost of living crisis, and the need to deliver a just transition to net zero.[37] Government (including devolved authorities) has the primary role in addressing fuel poverty, but we will consider interventions where vulnerable consumers are at significant risk, the benefits of the intervention are significant, and the redistribution costs are low.

Role of the GDNs in supporting consumers in vulnerable situations

SSMC summary

4.3 In our SSMC, we proposed that the GDNs should continue to play a crucial role in assisting consumers in vulnerable situations (including those in fuel poverty) within their existing areas of competence, activity and consumer interaction, and where they are best placed to do so.[38] We also said that they should have a role in supporting a just transition for those most at risk of being left behind in the transition to net zero.

[37] Our current Consumer Vulnerability Strategy defines vulnerability to be when a consumer's personal circumstances and characteristics combine with aspects of the market to create situations where the consumer is significantly less able than a typical domestic consumer to protect or represent their interests; and/or is significantly more likely than a typical domestic consumer to suffer detriment, or that detriment is likely to be more substantial. This strategy runs until 2025, and we aim to refresh this ahead of the RIIO-3 price control. For more information about the Ofgem Consumer Vulnerability Strategy, see: https://www.ofgem.gov.uk/publications/consumer-vulnerability-strategy-2025

[38] This role, as defined in RIIO-GD2, includes assisting consumers in vulnerable situations during outages, taking proactive measures to identify and address vulnerability when responding to emergencies, properly accounting for vulnerability in customer service functions and offering additional assistance to identified vulnerable consumers.

Summary of consultation responses

4.4 Most stakeholders supported our proposal for the GDNs to continue to assist consumers in vulnerable situations, through their existing areas of competence, activity and consumer interaction, and where they are best placed to do so.

4.5 Many stakeholders highlighted the increasing numbers of customers living in vulnerable situations, and the increasing complexity of these cases. Several respondents considered the GDNs uniquely placed to identify and support consumers living in vulnerable situations. Others emphasised the need for the GDNs to have a defined role as part of a whole system approach to vulnerability.

4.6 Stakeholders were generally in agreement that the GDNs should have a role in delivering a just transition, through supporting those most at risk of being left behind in the transition to net zero. While there were limited specific examples, one GDN suggested that the GDNs should continue to provide energy efficiency advice in collaboration with the DNOs and partner organisations. However, a consumer group questioned whether the GDNs are best placed to fund energy advice and charity partnerships, as it said that this could be inefficient and duplicate efforts by other organisations. Another GDN highlighted a need for forward thinking and adaptability in response to unpredictable challenges resulting from the energy transition, people living longer and the cost of living crisis. One stakeholder thought the GDNs' role should focus on supporting customers to switch away from gas, including through addressing disconnection charges.

4.7 Some respondents wanted to expand the role of the GDNs to also include the installation of energy efficiency measures, but a consumer group expressed that these measures should continue to be delivered through government schemes such as ECO. One GDN considered its role could be to coordinate a "whole house" approach with third parties to maintain safe, efficient and warm homes. The GDN, and other stakeholders, acknowledged that the GDNs' role should complement, and not duplicate, existing funding structures where they are available, with some respondents encouraging greater collaboration and alignment between the GDNs and DNOs.

SSMD decision and rationale

4.8 We have decided that the GDNs should continue to address consumer vulnerability within their existing areas of competence, activity and consumer interaction. This should include supporting a just transition to net zero, where they are best placed to do so.

4.9 We recognise the concern about the GDNs using RIIO funding for energy efficiency advice and charity partnerships projects. It is therefore vital that the GDNs coordinate and work with organisations in this area to maximise their impact. The GDNs' initiatives should complement other funding mechanisms, particularly government ones, to avoid duplication and ensure efficiency. We will work with stakeholders to update the Vulnerability and Carbon Monoxide Allowance (VCMA) Governance Document,[39] which governs how RIIO funding is spent, ahead of RIIO-3. As part of this, we will consider project eligibility requirements, and whether any changes could facilitate better adaptability to challenges arising from the net zero transition and coordination with other funding mechanisms and third parties (including the DNOs).

4.10 We are mindful of our wider work in Ofgem looking at debt and affordability in the retail market. This will consider affordability issues and support for consumers in vulnerable situations. We expect to issue a discussion document later in the summer and this could include some consideration of the potential role of networks. We will ensure we are aligned with this project and will consider any resulting policy, if appropriate, in our Draft Determinations.

Vulnerability strategies

SSMC summary

4.11 The GDNs each maintain and update individual vulnerability strategies tailored to the needs of their consumers. These strategies inform the GDNs' BAU activities and use of their VCMA and should be informed by and tested with stakeholders, Project Partners,[40] and Independent Stakeholder Groups (ISGs).

4.12 In our SSMC, we proposed that the GDNs should continue to develop individual vulnerability strategies, and should develop a joint-GDN vulnerability strategy together. These strategies should cover both VCMA and BAU approaches. The joint strategy could facilitate knowledge sharing, collaboration and progress on cross-sector challenges like delivering a just transition and data use for vulnerability identification and action. We proposed to require these strategies as part of the VCMA Governance Document. We proposed that the vulnerability

[39] https://www.ofgem.gov.uk/decision/decision-update-riio-2-gas-network-vulnerability-and-carbon-monoxide-allowance-governance-document
[40] Defined in version 2 of the VCMA Governance Document as a third-party organisation that makes a contribution which is related to the success of the VCMA Project.

strategies should inform the GDNs' business plans but said that we do not expect to require their submission through the Business Plan Guidance.

Summary of consultation responses

4.13 All stakeholders supported continuing the requirement for GDNs to develop, maintain and update individual vulnerability strategies to help the GDNs respond to the specific needs within their networks.

4.14 Stakeholders had mixed views on introducing a joint-GDN vulnerability strategy. Those in favour said that it would encourage collaboration, share learning and best practice, further enable the rollout of successful initiatives, mitigate risk of a postcode lottery and help address cross-sector issues (including developing a multi-sector Priority Services Register (PSR)). They also said that it would provide one document for stakeholders to find overarching information on the GDNs' approaches to vulnerability. Stakeholders said that a joint-GDN strategy should account for different needs across the networks and avoid creating barriers to being adaptable and innovative. Other stakeholders considered a joint-GDN strategy unnecessary given existing requirements and collaboration between the GDNs. They were also concerned that it could impede the GDNs' having tailored approaches to vulnerability. One GDN considered that having one vulnerability strategy, rather than multiple documents, would be easier for stakeholders to reference and find information.

4.15 More generally, some stakeholders supported better and more transparent ways to compare, monitor and share performance against the vulnerability strategies. They encouraged proactive engagement with wider and more diverse groups to ensure strategies are evidence-based using consumer research. One response suggested that the GDNs should focus on communities as well as end users.

4.16 A consumer group said that the strategies should be published regularly so they can be scrutinised. Another stakeholder requested that vulnerability strategies be mandated through the licence, while a third proposed that the GDNs should submit their vulnerability strategies alongside their business plans.

SSMD decision and rationale

4.17 We have decided to retain the requirement for the GDNs to each maintain and update individual vulnerability strategies, given their key role in shaping GDNs' approaches to vulnerability. These strategies should cover both VCMA and BAU vulnerability initiatives. They should continue to be developed and tested with diverse stakeholders, Project Partners and ISGs, and based on evidence from

consumer research. We will continue to include the requirement for these strategies through the VCMA Governance Document because, while it is an associated document to the licence, it can be more readily amended in response to emerging issues. We will consider how to monitor the GDNs' delivery against their vulnerability strategies as part of updating the VCMA Governance.

4.18 We have also decided to introduce a requirement for the GDNs to develop and maintain a joint-GDN vulnerability strategy, covering VCMA and BAU approaches to vulnerability. Given the uncertain vulnerability challenges in RIIO-GD3, we consider that a joint strategy will facilitate a collaborative approach (both with each other and wider stakeholders) to identifying, anticipating and responding to issues as they emerge. We consider that a high-level strategy with sufficient flexibility and recognition of different network contexts can mitigate the risk of impeding tailored approaches. The joint-GDN strategy should be maintained and updated to meet the needs of consumers in vulnerable situations and will also be required through the VCMA Governance Document. Ahead of RIIO-GD3, the GDNs should work together, in collaboration with stakeholders, to determine the themes and focus areas to include in the joint-GDN strategy.

4.19 The GDNs should ensure the most up-to-date versions of their individual and joint-GDN vulnerability strategies, including executive summaries, are easily accessible to stakeholders on their websites, and they should notify stakeholders when updates to these documents are made.

4.20 We have decided to require the GDNs to submit their individual vulnerability strategies and a draft of their joint-GDN vulnerability strategy (including executive summaries) alongside their business plans. This is a change to our SSMC proposal, but we think this approach will provide us with a greater overview of the GDNs' approaches to addressing vulnerability.

Vulnerability minimum standards

SSMC summary

4.21 RIIO-GD2 has several vulnerability minimum standards for the GDNs:

- an LO to provide additional services to specified customer groups;
- a principles-based LO to treat domestic customers fairly; and
- the GSOPs, which are discussed in more detail later in this chapter (see paragraphs 4.139-4.149).

4.22 In our SSMC, we proposed to maintain the existing vulnerability minimum standards in RIIO-GD3. We considered these standards necessary to protect consumers in vulnerable situations and to ensure they can expect fair treatment from the GDNs.

Summary of consultation responses

4.23 Stakeholders supported maintaining the existing minimum standards, generally considering them to be appropriate and sufficient to protect consumers.

4.24 Two stakeholders recommended that we undertake a further review of the minimum standards to ensure they continue to meet future needs and customer expectations. One respondent considered that RIIO-GD3 offers an opportunity to streamline and clarify the standards.

SSMD decision and rationale

4.25 We have decided to retain the current minimum standards in RIIO-GD3, as we continue to consider these to be sufficient to protect consumers in vulnerable situations. We have considered funding BAU vulnerability activities through the baseline allowances in paragraphs 4.40-4.42 below.

4.26 We have not seen strong evidence to support a further review of the vulnerability minimum standards ahead of RIIO-GD3. However, if any new evidence is provided, or if stakeholders suggest how the licences can be clarified, we will consider if further updates to these standards are appropriate.

Vulnerability and Carbon Monoxide Allowance (VCMA)

Use of VCMA or an ODI-F

SSMC summary

4.27 The VCMA was introduced in RIIO-GD2 for the GDNs to fund projects focused on vulnerability and carbon monoxide (CO) safety initiatives which go beyond the BAU activities funded through other price control mechanisms or required through the minimum standards.[41] The VCMA is a UIOLI allowance, so any unspent allowances at the end of RIIO-GD2 will be returned to consumers.

4.28 In RIIO-ED2, Distribution Network Operators (DNOs) are funded through baseline allowances to deliver their vulnerability strategies, and an ODI-F drives ambition and ensures accountability. The ODI-F covers PSR reach, support for those in fuel

[41] The GDNs must ensure that their VCMA portfolio covers a range of activities (related to both vulnerability and CO safety) which are aligned with their vulnerability strategies.

poverty and those at risk of being left behind in the net zero transition, and the customer satisfaction of consumers in vulnerable situations.

4.29 Our SSMC considered which approach would be most appropriate for RIIO-GD3. We acknowledged that both UIOLI and ODI-F approaches have advantages and disadvantages. However, given that the GDNs have a different role to the DNOs in addressing vulnerability, and the benefits of providing consistency for GDNs and project partners, we proposed to retain the VCMA UIOLI allowance in RIIO-GD3.

Summary of consultation responses

4.30 Most stakeholders strongly supported retaining the VCMA UIOLI allowance. Respondents stated that the VCMA's flexibility enables the GDNs to:

- adapt and respond to changing needs and priorities;
- help build effective partnerships with both local grassroots organisations and national organisations;
- collaborate, share knowledge and roll successful projects out nationally; innovate; and
- provide predictable funding for partner organisations to plan projects.

4.31 Respondents also stated the UIOLI mechanism safeguards consumers from funds not being spent.

4.32 Some stakeholders said that an ODI-F approach could create competition between GDNs which could: inhibit collaboration and beneficial risk taking; reduce flexibility; limit GDNs' ambitions; encourage GDNs to focus on metrics rather than broader outcomes; require resource intensive oversight; and reduce confidence to make longer-term commitments with project partners.

4.33 However, other stakeholders suggested that an ODI-F could also have benefits. Two stakeholders stated that ODI-Fs are appropriate for addressing vulnerability, highlighting that the RIIO-ED2 ODI-F has encouraged the DNOs to invest and innovate. One of these stakeholders suggested that we retain the VCMA in RIIO-GD3 but consider how quantitative and qualitative outcomes could provide a basis for future incentive design. A GDN suggested that an ODI-F could be introduced in addition to the VCMA to incentivise better customer outcomes. However, another respondent considered that the delivery of higher quality projects could instead be achieved through setting a minimum social return on investment (SROI) for VCMA projects.

SSMD decision and rationale

4.34 We have decided to retain the VCMA UIOLI allowance in RIIO-GD3. Given the GDNs' specific role in supporting consumers in vulnerable situations, we think the benefits offered by keeping the UIOLI allowance outweigh the advantages offered by changing our approach to an ODI-F. We consider that different approaches in ED and GD are appropriate given the differences in DNOs' and GDNs' vulnerability functions, eg that GDNs do not own and operate a PSR.

4.35 We will update the VCMA Governance Document ahead of RIIO-GD3 to ensure high-quality outcomes for consumers in vulnerable situations, and as part of this will consider setting a minimum SROI for projects.

Funding BAU vulnerability initiatives through baseline allowances

SSMC summary

4.36 In our SSMC, we invited views on whether some vulnerability initiatives (such as training staff in identifying vulnerabilities, service signposting or some safeguarding services) can now be considered BAU and so could be placed into baseline allowances in RIIO-GD3 rather than being funded through the VCMA. We said that this approach could ensure that these initiatives are embedded in BAU and it could also allow the VCMA to be spent on more innovative or bespoke projects.

Summary of consultation responses

4.37 Most stakeholders supported including certain vulnerability activities which are now considered BAU in baseline allowances. Those in favour of our proposals (including two GDNs) considered that this approach would embed vulnerability activities as BAU, allow the VCMA to focus on bespoke or innovative initiatives that go beyond BAU services, provide greater certainty to partners, and create a lasting VCMA legacy of increased customer support. One GDN stated that it currently funds some basic vulnerability activities through its baseline allowances, while another said that CO safety campaigns should continue to be captured within the VCMA.

4.38 Respondents suggested BAU vulnerability activities suitable for baseline allowances include:

- additional services delivered through engineers (eg additional CO investigations or repairs to pipework and appliances whilst on site, with appropriate safeguards);
- specialised vulnerability training;

- service signposting;
- in-house referral triage services; and
- some services beyond the meter (eg community support vans and possibly Centres for Warmth).

4.39 One GDN preferred increasing VCMA funding but was open to funding BAU activities through baseline allowances, and proposed possible cost assessment approaches to ensure these costs are assessed correctly. Another GDN strongly disagreed with funding vulnerability activities through baseline allowances. It considered that the VCMA provides a high level of transparency and accountability for expenditure that is outside of a GDNs' core services of operating a safe and resilient network.

SSMD decision and rationale

4.40 We have decided to allow the GDNs to place specific vulnerability and CO safety activities that are now considered BAU into baseline allowances. This will embed these activities and provide confidence for longer-term project planning. It will also enable the VCMA to be spent on initiatives which proactively respond to specific or emerging issues and enable project growth. We consider that transparency and accountability of BAU expenditure can be facilitated through the vulnerability strategies mentioned earlier in this chapter. We will also consider introducing additional reporting requirements.

4.41 To coordinate activities across the GDNs and avoid creating a postcode lottery, where customers receive different service levels based on where they live, GDNs (in collaboration with their ISGs, Project Partners and other stakeholders) are required to establish a list of common BAU activities that they will undertake through baseline allowances. Examples of common activities that may be considered BAU include additional welfare support for vulnerable customers during unplanned interruptions (see our related decision in paragraphs 4.247-4.248), specialised vulnerability training, service signposting, and in-house referral triage. However, we think services beyond the meter are bespoke and require flexibility, so these should continue to be funded through the VCMA.

4.42 The GDNs should submit an agreed list of common activities to us for review in September. We will then indicate which of these activities the GDNs' should consider BAU and where required bring forward requests for baseline allowances in their business plans. We will update the VCMA Governance to exclude activities funded through baseline allowances from the VCMA following our Final Determinations.

Level of VCMA funding

SSMC summary

4.43 Funding for the VCMA was set at £60m in RIIO-GD2. In June 2023, recognising the acute pressures facing consumers, we repurposed £111m of unspent funds from the GDNs' Fuel Poor Network Extension Scheme (FPNES). As a result, the total VCMA funding available in RIIO-GD2 is £171m (2018/19 price base).

4.44 While we considered the VCMA should be of sufficient scale to deliver tangible outcomes, we noted that it should be sustainable and proportionate to the impact of the projects in the longer-term. Therefore, we proposed to return VCMA funding to its original RIIO-GD2 level but updated to current prices - approximately £74m (2023/24 price base).

Summary of consultation responses

4.45 Most stakeholders disagreed with our proposals to return funding closer to its original RIIO-GD2 level. Several respondents suggested setting the funding level closer to the current £171m. These stakeholders highlighted:

- the impact on households and project partners of reducing funding;
- the limited availability and need for additional funding sources;
- the challenges of the energy transition; and
- the overall decrease in RIIO-GD3 vulnerability funding as a result of removing the FPNES (see paragraphs 4.204-4.206).

4.46 Respondents also stated that engagement shows that customers want to prioritise supporting consumers in vulnerable situations.

4.47 Three stakeholders recommended that we wait until we have reviewed evidence in the GDNs' business plans before we decide on an appropriate funding level.

4.48 A consumer group considered that the RIIO-GD2 level of £171m is too high and was concerned that this level of funding could result in inefficient spending. It supported returning to a lower funding level, while noting the need to consider the GDNs' actual delivery figures and the effect that reducing funding could have on partners and consumers in vulnerable situations. Another respondent stated that a lower funding level could be appropriate if we separately provide funding for some initiatives through baseline allowances.

SSMD decision and rationale

4.49 We expect to reduce VCMA funding to a level significantly below the RIIO-GD2 total of £171m. However, we will consider the evidence provided in the GDNs' business plan submissions before setting the funding level. We will consult on this in our Draft Determinations.

4.50 While demand for vulnerability services is continuing to increase, we are mindful of the GDNs' specific, and limited, role in addressing vulnerability. We recognise that many projects have delivered significant benefits for consumers in vulnerable situations. However, our decision to repurpose unspent FPNES funds was a one-off intervention. We consider it essential for VCMA funding to be set at a sustainable level to give certainty to partners, projects and consumers in vulnerable situations in the longer term.

4.51 Our separate decision to allow some vulnerability activities to be placed into baseline allowances will also support the continuation of BAU projects, while enabling greater focus to be placed on the VCMA to support initiatives which proactively address, or dynamically respond to, emerging need. We will consider how much baseline funding has been provided when deciding on the VCMA funding level.

Ringfencing for VCMA funds for collaborative projects

SSMC summary

4.52 In RIIO-GD2, 25% of VCMA funding is ringfenced for collaborative projects between two or more GDNs. The ringfenced allowance sets the minimum percentage of VCMA funding to be spent collaboratively, and we welcomed views on whether this percentage should be increased in RIIO-GD3.

Summary of consultation responses

4.53 Most stakeholders supported maintaining the minimum ringfenced funding for collaboration at 25% of the total VCMA. Respondents recognised the benefits of collaboration, including the sharing of learning and best practice, taking advantage of economies of scale and reducing the risk of creating a postcode lottery. However, respondents also considered that maintaining the 25% minimum allows GDNs to address network-specific issues and enables trials which can be replicated through collaborative projects. Some stakeholders stated that raising the 25% minimum may disadvantage smaller partner organisations which might not have the capacity or ability to deliver bigger projects.

4.54 One stakeholder supported increasing the percentage of funds ringfenced for collaboration, as it said that it could increase innovation, reach and impact. Another stakeholder suggested that we should consider how to encourage further collaboration without mandating it and suggested that the annual vulnerability showcase event could be used to assess the feasibility of scaling up individual projects.

SSMD decision and rationale

4.55 We have decided to continue to ringfence 25% of total VCMA funding for collaborative projects. We recognise the benefits of collaboration, but also consider it important for GDNs to address network (and customer) specific issues and deliver some smaller projects. We encourage the GDNs to look for opportunities to collaborate beyond this ringfenced minimum. We will consider if the annual showcase event requirements should be updated (see paragraphs 4.219-4.220).

VCMA funding allocation

SSMC summary

4.56 VCMA funding is currently allocated to the GDNs based on the number of domestic gas customers they serve. In our SSMC, we recognised that all GDNs have consumers in vulnerable situations in their network areas, but that vulnerability is not evenly distributed within, or across, the GDNs. We welcomed views on how VCMA funding should be allocated to ensure it has the maximum impact for consumers in vulnerable situations.

Summary of consultation responses

4.57 Most stakeholders considered the current method of allocating VCMA funding to be imperfect. However, around half of respondents (including three GDNs) considered that allocation based on the number of domestic customers served remains the most appropriate option. These stakeholders said that devolved governments having different measurements of fuel poverty and health creates a significant barrier to needs-based allocation, and that the multi-faceted factors contributing to vulnerability are challenging to capture through individual metrics. One respondent said that the current approach places responsibility on the GDNs to ensure allocated funding reaches those who need it.

4.58 Other stakeholders considered it fairer to allocate funding based on need. One GDN said that it was researching how this could be delivered, while other stakeholders recommended using local and cross-sector data to identify need and

target funding. One response suggested following the approach taken in RIIO-ED2 to set PSR reach targets for DNOs, which used census data to calculate the number of households with people who could be considered eligible for the PSR. Another stakeholder recommended we undertake a full distributional analysis on our preferred option.

4.59 Some stakeholders suggested that where a GDN has responsibility for more than one network area, there should be flexibility for it to transfer funding between its network areas.

SSMD decision and rationale

4.60 We have decided to continue to allocate VCMA funding based on the number of domestic customers served.

4.61 While the current allocation approach is imperfect, there are considerable challenges in identifying and determining vulnerability need across the networks. The intersecting and multidimensional nature of vulnerability, combined with difficulties in comparing measurements of vulnerability across the devolved governments, mean an alternative approach could risk being overcomplicated and inappropriately allocating funds to the detriment of consumers in vulnerable situations. We think that the current approach to allocation places responsibility on the GDNs to ensure funding reaches those who need it most, and we encourage further efforts to understand and identify vulnerability and improve the targeting of initiatives.

4.62 We have decided not to allow GDNs with more than one network to reallocate the funds assigned to them across their network areas. We are concerned about creating a cross-subsidy which would unfairly charge consumers for initiatives outside their network region and consider this could create a postcode lottery.

Adding value to VCMA partnerships

SSMC summary

4.63 VCMA projects are delivered in collaborative partnership between the GDNs and other organisations. To further cultivate effective partnerships and integrate insights, we welcomed views on how learnings from VCMA projects and partners can best inform the GDNs' organisational approaches to vulnerability.

Summary of consultation responses

4.64 Most stakeholders considered that learnings from VCMA projects are being effectively used to inform GDNs' approaches to vulnerability. Some respondents provided examples of where this has worked well, including where Project

Partners have reviewed safeguarding strategies or ensured accessible communications approaches. Stakeholders highlighted the importance of ongoing project partner engagement and customer research for incorporating insights into the GDNs' vulnerability strategies, BAU activities and VCMA projects.

4.65 Other stakeholders suggested that learnings from VCMA projects could be better integrated. They considered that embedding successful VCMA projects as BAU may help with this. One GDN recommended that we should require the clear capture of customer and stakeholder input into the design of VCMA-funded projects. Another stakeholder encouraged the GDNs to develop an evidence base of effective interventions to share with stakeholders to inform best practice.

4.66 One respondent cautioned against setting out formal approaches, eg stipulating which stakeholders should be involved and specific approaches, suggesting that this could limit the exchange of good practice and create bias. .

SSMD decision and rationale

4.67 The GDNs should continue to work with project partners and stakeholders to capture and integrate learnings from VCMA projects. We will consider updating the VCMA Governance Document ahead of RIIO-GD3 to require GDNs to further incorporate customer and stakeholder input into the design of projects through project registration requirements, and to increase reporting of project/partner learnings and how these have been integrated into the core business and vulnerability projects.

Customer Satisfaction ODI-F

ODI-F design

SSMC summary

4.68 The Customer Satisfaction (CSAT) ODI-F is designed to maintain excellent customer service, with financial rewards for exceptional performance and financial penalties to prevent performance deterioration. The RIIO-GD2 incentive has a cap and collar of ±0.5% of base revenue.

4.69 We proposed several options for the ODI-F in our SSMC to consolidate the improvements in customer satisfaction.

4.70 The first option was to maintain the RIIO-GD2 incentive design with rewards and penalties available up to ±0.5% of base revenue, dead bands, and common static targets.

4.71 The second option was a penalty-only ODI-F to ensure performance does not deteriorate but also not incentivise further improvement as the performance scores are already high.

4.72 Our third option was to use relative rewards and penalties, with the best performing network(s) rewarded and the lowest performing network(s) receiving a penalty. However, we noted that this approach could reduce collaboration between the GDNs and asked for evidence of the benefits that collaboration provides to consumers.

Summary of consultation responses

4.73 Most respondents, including all the GDNs, supported retaining the RIIO-GD2 incentive design in RIIO-GD3. They said that the ODI-F drives the GDNs to deliver high levels of service and that the rewards are often reinvested into customer services. They stated that maintaining high survey scores requires continuous investment and innovation to meet customer expectations, and the current ODI-F design enables the GDNs to collaborate on best practice.

4.74 No respondents favoured a penalty-only ODI-F. Most stakeholders said that this approach could reduce investment in customer services and innovation as the absence of rewards would make it more challenging to develop an internal business case for improvement. There was concern that a penalty-only design could create a perverse incentive for GDNs to not collaborate and only "do enough" to avoid a penalty.

4.75 A consumer group stated that the CSAT ODI-F should include a financial reward as the GDNs could have increasing areas of customer interaction due to the net zero transition (eg for disconnections). It preferred the third option to use relative rewards and penalties, which it said could encourage the GDNs to improve performance without customers overpaying. It said that this aligned with the Department for Business and Trade's Smarter Regulation proposals to introduce more relative performance targets for regulated industries. Other stakeholders, including all four GDNs, were not supportive of this approach, with one highlighting that Ofwat is moving away from relative incentivisation. These stakeholders suggested that greater competition between the GDNs in this area would mean that they no longer collaborate. This could cause inconsistency in service, standards to diverge and make it more difficult for lower scoring networks to align with sector leaders.

4.76 The GDNs provided evidence that collaboration has been beneficial, including in sharing best practice, identifying emerging trends, advancing access to relevant

customer data and incorporating vulnerability insights for customer service interactions with PSR customers.

SSMD decision and rationale

4.77 We have decided to retain the RIIO-GD2 CSAT ODI-F incentive design in RIIO-GD3. We will set the incentive cap and collar at the equivalent basis points (bps) of RoRE to the RIIO-GD2 cap and collar of 0.5% of base revenue.

4.78 We recognise the success of the existing incentive design in improving and facilitating convergence of the GDNs' CSAT performance and consider that retaining this design will continue to consolidate the GDNs' high levels of performance. We think that a penalty-only approach could lead the GDNs to deprioritise focusing on customer satisfaction at a time when customer interactions could increase due to the net zero transition. We consider that relative targets would overcomplicate the ODI-F and reduce collaboration, which would be detrimental to consumers as it could inhibit the implementation of best practice and reduce customer service convergence.

Target setting

SSMC summary

4.79 In our SSMC, we recognised that there have been significant improvements in the GDNs' Customer Satisfaction scores since the beginning of RIIO-GD1. In the first two years of RIIO-GD2, every network has received a reward in at least one of the three survey areas and no GDN has received a penalty so far.

4.80 We proposed to recalibrate the static annual incentive targets for rewards, penalties and deadbands if we retain the current incentive design.

Summary of consultation responses

4.81 Several respondents supported recalibrating targets to reflect RIIO-GD2 performance. A consumer group suggested using only RIIO-GD2 data to set dynamic RIIO-GD3 targets, to avoid over-rewarding GDNs and to adapt to performance improvements during RIIO-GD3. Another respondent said that static targets are beneficial for forecasting the cost-benefit of initiatives. One GDN disagreed with the need for significant changes as the overall maximum reward for the ODI-F is not being achieved, while another said that there is limited scope to deliver even higher scores. A GDN said that targets should have regional adjustments as there are differences in how customers score satisfaction across GB.

SSMD decision and rationale

4.82 We have decided to retain static annual targets, which we will recalibrate for RIIO-GD3. These will consolidate high performance in areas of customer satisfaction to reflect the improvements made in RIIO-GD2. We will consult on proposed recalibrated targets in our Draft Determinations.

4.83 We do not consider dynamic targets necessary as we consider there is limited scope for GDNs to continue to improve performance. For a reward incentive to be effective it must be realistically attainable, and we consider that dynamic targets could set these out of reach in some survey areas.

4.84 We will use RIIO-GD2 data to update the targets for RIIO-GD3 at Draft Determinations and we will consider setting asymmetrical deadbands. We acknowledge that there could be changes in customer expectations, eg resulting from the removal of the Domestic Load Connections Allowance (DLCA), but we consider that these are difficult to quantify and include in the recalibration of targets. We also think customers should be able to expect the same standard of customer service regardless of where they live, and therefore will not provide regional adjustments to the targets.

4.85 As well as reporting on the annual targets, we will require the GDNs to report a monthly breakdown of their CSAT performance in the RRPs so we can monitor whether customers are receiving consistently high levels of service throughout the year. While we will not use monthly data to calculate the ODI-F incentive, it will enable us to better understand and address issues in a timely manner.

Scope and weighting of surveys

SSMC summary

4.86 In our SSMC, we proposed to maintain the three survey areas in RIIO-GD3: planned work, unplanned work and connections.

4.87 We also said that we would consider amending the survey weightings to prioritise areas for improvement, including introducing asymmetric deadbands to make rewards harder to achieve and raising the fixed targets to reward only exceptional performance. We also suggested introducing asymmetric incentive values to balance the level of risk and reward for GDNs.

Summary of consultation responses

4.88 Two GDNs said that declining numbers of connections could lead to the connections survey metric becoming statistically unreliable during RIIO-GD3.

They also encouraged us to consider the impact that removing the DLCA could have on response volumes and scores. One GDN proposed that this metric should be removed from the ODI-F once connections survey responses fall below a pre-agreed minimum level.

4.89 This GDN, alongside another stakeholder, proposed adding a new survey to the ODI-F for disconnections once responses reach a pre-agreed and statistically reliable level. It suggested that a pilot survey should be used to determine baseline scores.

4.90 The GDN also recommended considering introducing surveys for industrial and commercial (I&C) customers and worst-served customers, to address pockets of lower performance.

4.91 Some stakeholders, including two GDNs, suggested reviewing the survey weightings to focus incentives on areas with weaker performance or which are most important to consumers. Two respondents encouraged asymmetric incentive values with greater upsides to incentivise improvements where required.

SSMD decision and rationale

4.92 We have decided to retain the three existing survey areas in RIIO-GD3. However, we will consider putting in place a trigger to enable us to remove the connections survey and/or introduce a disconnections survey should customer response levels reach a pre-determined level.

4.93 We will work with stakeholders to determine the level at which we will consider removing the connections survey from the CSAT ODI-F. Should connections numbers increase back above this threshold, we will reintroduce the connections survey to the ODI-F. In the event that we remove the connections survey from the ODI-F, we will consider whether enacting this on an individual or collective network basis best serves the interests of consumers. If we remove the connections survey during RIIO-GD3:

- we will continue to require the GDNs to report on their connections surveys in their RRPs but there will be no financial incentive attached;
- we will consider reporting this information through the RIIO annual report databook to ensure GDNs are accountable to stakeholders for their performance; and
- we will consider whether to reallocate the incentive across the remaining survey areas.

4.94 We have decided that a disconnections survey should be developed. We intend to work with stakeholders ahead of RIIO-GD3 to develop and implement a pilot survey for this area, with the GDNs initially reporting scores through the RRPs but this not being included in the CSAT ODI-F. Should disconnections survey responses reach a pre-agreed, statistically reliable level, we will consider incorporating it into the ODI-F during RIIO-GD3, using the pilot data to set targets. If we introduce a disconnections survey, we will consider whether to reallocate the survey weightings in the incentive so this remains equal across all survey areas. In the event that we introduce the disconnections survey to the ODI-F, we will consider whether implementing this on an individual or collective network basis best serves the interests of consumers.

4.95 We do not consider it necessary to introduce specific I&C and worst served customer surveys in RIIO-GD3 as these groups are already sufficiently accounted for through the existing CSAT surveys and the Complaints Metric ODI-F. In particular, given that I&C customers may remain connected to the gas network even in the event of increasing domestic customer disconnections, they are likely to make up an increasing proportion of overall GD customers and, consequently, an increasing proportion of existing CSAT survey responses.

4.96 We have decided to continue to equally weight the survey areas in the ODI-F. We do not consider it necessary to amend the weighting to focus performance on a particular survey area for RIIO-GD3. All survey areas remain important and the GDNs' performance is good, and relatively consistent, across all existing surveys.

PSR Customer Satisfaction ODI-R

SSMC summary

4.97 We proposed to maintain reporting of Customer Satisfaction scores for customers on the PSR through the RRPs. In RIIO-GD2, this reporting is part of the Consumer Vulnerability ODI-R, but we proposed to remove this and instead require reporting through the RRPs.

Summary of consultation responses

4.98 We received no SSMC responses on this specific area. However, one consumer group said that greater access to information and standardisation is needed if we retain the Consumer Vulnerability ODI-R, to ensure that comparable data is available to stakeholders (see paragraph 4.209).

SSMD decision and rationale

4.99 We have decided to introduce a PSR Customer Satisfaction ODI-R, as we are removing the Consumer Vulnerability ODI-R (see paragraphs 4.210-4.213). The PSR Customer Satisfaction ODI-R will have the same annual targets as those in the CSAT ODI-F. This ODI-R will provide stakeholders with standardised information to hold GDNs accountable for delivering similar levels of customer satisfaction for those on the PSR and their general customer base. We consider that this should be separate to the main CSAT ODI-F because the GDNs can already be penalised or rewarded for the same survey responses through the ODI-F so this would result in double counting.

Complaints Metric ODI-F

ODI-F design

SSMC summary

4.100 RIIO-GD2 includes a penalty-only complaints ODI-F to ensure that the GDNs maintain quick and effective performance in their handling of complaints. The overall minimum performance level and outturn score is based on combining four weighted indicators. The lower the overall score, the better a GDN is performing under the metric. The indicators are based on the percentages of:

- complaints unresolved in one day (Day (D+1) (10% weighting);
- complaints unresolved in 31 days (D+31) (30% weighting);
- repeat complaints (50% weighting); and
- the number of Energy Ombudsman decisions that go against the GDN (as a percentage of total complaints) (10% weighting).

4.101 Penalties are applied linearly above the minimum performance level of five, with a maximum penalty of 0.5% of base revenue for scores of ten or above.

4.102 Our SSMC proposed to retain the RIIO-GD2 ODI-F design in RIIO-GD3.

Summary of consultation responses

4.103 Most respondents supported retaining the design of the RIIO-GD2 penalty-only mechanism, highlighting the improvements in performance to date. They considered that the ODI-F encourages GDNs to balance speed and effectiveness of complaint resolution, without discouraging the logging of complaints.

4.104 One GDN stated that the current ODI-F design negatively affects GDNs that focus on "getting it right first time". It said that, under the current ODI-F design, networks with a high volume of easily resolvable complaints can achieve better Complaints Metric ODI-F scores than a network that has a lower volume of complaints but which are on average more complex and therefore more challenging to resolve. The GDN encouraged us to measure customer service performance in a more holistic manner, similar to the approach taken for suppliers. This includes accounting for volumes of complaints in relation to customer base, which could improve understanding of customer service performance and mitigate distortion of the GDNs' complaints rankings.

4.105 Another GDN commented that the lower the volume of complaints, the more challenging it is for the ODI-F to work, since the metrics are linked to a percentage of overall complaints.

SSMD decision and rationale

4.106 We will retain the penalty-only Complaints Metric ODI-F in RIIO-GD3. The incentive collar will be set at the equivalent bps of RoRE to the RIIO-GD2 incentive collar of 0.5% of base revenue.

4.107 We have decided not to update the ODI-F design to take into account the complexity of complaints, as it is not clear how this could be implemented or if it would drive beneficial behaviour. We recognise that a GDN with more complicated complaints could perform poorly against the unresolved complaints at D+1 and D+31 metrics, even if they have a low number of complaints overall. However, beyond our current approach of monitoring the timeframe for resolution, we are not aware of a way to quantify how challenging a complaint is, and it is unclear to what extent complex complaints affect the GDNs' performance.

4.108 We acknowledge the view that if there are lower volumes of complaints, the scores could be more affected by individual survey responses and could therefore be more variable. However, a lower volume of complaints should also increase the GDNs' resource capacity to address and resolve remaining cases within the timeframe metrics. We therefore do not consider that the ODI-F design needs to be updated to account for this.

Target setting

SSMC summary

4.109 In RIIO-GD2 we set a common static target of five, with GDNs receiving a penalty for scores above this.

4.110 The GDNs have made significant performance improvements in RIIO-GD1 and RIIO-GD2, and no GDNs have been subject to penalties to date. However, we noted that there are still differences in performance between the GDNs.

4.111 In our SSMC, we proposed to maintain the Complaints Metric in RIIO-GD3 with a static target, set at either:

- the lower of the current target of five; or
- the average industry performance across RIIO-GD1 and RIIO-GD2.

4.112 We also discussed setting a dynamic target but did not propose to do so as we considered this could add unnecessary complexity.

Summary of consultation responses

4.113 Several stakeholders stated a preference for maintaining a static target, with all GDNs in favour of retaining the target score of five.

4.114 One consumer group preferred a dynamic target to avoid outperformance and to reflect the GDNs' good performance to date.

4.115 Two GDNs stated that a dynamic target or a target below five would reduce collaboration, discourage the recording of complaints and add complexity. One GDN commented that lower complaints volumes make it more challenging to deliver lower scores, while another encouraged us to consider the impact removing the DLCA and increasing numbers of disconnections could have on complaints.

4.116 However, a DNO and a supplier suggested that the targets are not stretching enough, given that there have been no penalties in RIIO-GD1 or RIIO-GD2 so far. The supplier considered that a target of five would allow for significant deterioration in performance without penalty. It also suggested that we should discount outlying data when setting targets.

4.117 One GDN stated that it is difficult to compare the GDNs' performance as there is no agreed definition of the term "complaint" and it thinks that the GDNs are inconsistent in when they consider complaints to have been resolved.

SSMD decision and rationale

4.118 We have decided to retain a static target in RIIO-GD3. We do not consider that a dynamic target is necessary as performance levels are already high and we think that there is limited scope for ever-increasing scores. We will consult on a static target score in our Draft Determinations.

4.119 We note there could potentially be an impact on complaints resulting from more disconnections and the removal of the DLCA. However, we consider these are difficult to quantify and include in the recalibration of targets.

4.120 To ensure consistency and comparability, we will continue to require all the GDNs to apply the definition of "complaint" as defined in the Complaints Handling Regulations.[42] We will engage with the GDNs and other stakeholders via working groups to agree a common interpretation and application of this definition, including at what point a complaint should be considered to be resolved. To ensure clarity, we will consider embedding additional detail into the licence during the RIIO-3 licence drafting process.

Timeframe metrics

SSMC summary

4.121 We welcomed views on whether the unresolved complaint timeframe indicators of D+1 and D+31 remain the most appropriate timeframes to measure.

Summary of consultation responses

4.122 A consumer group and a DNO supported additional or amended timeframe indicators to encourage timely resolutions to complaints in the intervening period between D+1 and D+31. The DNO suggested that any additional indicators should be introduced on a reputational basis.

4.123 Two GDNs were open to amending the timeframe indicators. One suggested that the D+31 indicator could be amended to D+14. It said that complaints exceeding D+31 will often be referred to the Energy Ombudsman, so are already captured through the Energy Ombudsman indicator. It therefore considered a D+14 indicator would incentivise quicker resolution of challenging complaints.

4.124 Most other respondents, including the remaining two GDNs, preferred retaining the existing timeframe indicators and considered them effective at ensuring complaints are resolved quickly and effectively. A DNO said that additional, shorter timeframe indicators would bring unnecessary complexity and could create a perverse incentive for GDNs to get customers to agree to unreasonable resolutions to meet targets.

[42] The Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008

4.125 A GDN also proposed that we set a cut-off time so that complaints received after working hours start from the following day, with the ODI-F timescales commencing from this point.

SSMD decision and rationale

4.126 We have decided to retain the existing ODI-F timeframe indicators of D+1 and D+31. However, we will also require the GDNs to report on unresolved complaints at D+14 in their RRPs, and we will consider publishing this information as part of the RIIO annual report databook for transparency. We note the comment that complaints exceeding D+31 will often be referred to the Ombudsman. However, we have analysed data provided by the GDNs' showing unresolved complaints against time and have not found evidence that they delay resolving complaints after D+1 until nearer the D+31 indicator. We therefore do not consider that replacing the D+31 indicator with D+14 will drive better performance and agree that this could incentivise poor behaviour to seek a quick, but unreasonable, solution. However, introducing D+14 reporting in the RRPs will allow us to better monitor performance in this area.

4.127 We have decided that the timeframe for complaints received after working hours should start on the next day. For example, for complaints received after working hours on Monday, Tuesday would be Day 0 and Wednesday would be D+1. We consider this to be a reasonable approach, as the GDN will not review the complaint until the following day. We will work with the GDNs to determine an appropriate cut-off time as part of the licence drafting process.

Complaints volume reporting

SSMC summary

4.128 Alongside their performance against the Complaints Metric ODI-F target, we proposed to require the GDNs to report through their RRPs on the total volume of complaints received as a percentage of the number of customers served. This would provide greater transparency of performance. We did not propose to attach a financial incentive to this.

Summary of consultation responses

4.129 Approximately half of respondents, including three GDNs, supported publishing the number of complaints as a percentage of total customer base. Two stakeholders said that an ODI-F on complaints volumes could drive the wrong behaviours, and three other stakeholders either saw no rationale for reporting this data or considered it could create a perverse incentive. Two GDNs said that

complaints should not be discouraged. The GDNs provided us with provisional data on this area to assist our consultation process.

SSMD decision and rationale

4.130 We have decided to require the GDNs to report in their RRPs on the volume of complaints received as a percentage of the total number of customers served. We will include this information in our RIIO annual report databook so that stakeholders have visibility of it. However, we will not attach an ODI-F to this information to mitigate any perverse incentive for GDNs to discourage complaints or not record them.

4.131 As with the Customer Satisfaction ODI-F, we will also require the GDNs to report a monthly breakdown of their Complaints ODI-F performance in the RRPs. We will not use this monthly data to calculate the ODI-F incentive, but it will enable us to better understand and address localised issues in a timely manner and ensure customers are receiving consistently high levels of complaints handling throughout the year.

PSR Customer Complaints ODI-R

SSMC summary

4.132 In the SSMC, we considered introducing a requirement for GDNs to report on Complaints Metric data for customers on the PSR through their RRPs.

Summary of consultation responses

4.133 Stakeholders supported reporting Complaints Metric data for customers on the PSR in the GDNs' RRPs. A consumer group stated it would be useful to have comparable data publicly available to get insight into customer service issues.

SSMD decision and rationale

4.134 We have decided to introduce a separate PSR Customer Complaints ODI-R. This will require the GDNs to publicly report a breakdown of their PSR-only complaints scores and will provide stakeholders with standardised information to hold the GDNs accountable for delivering similar standards of complaints handling for those on the PSR and their general customer base. The ODI-R target will be the same as the complaints ODI-F target.

Relationship between complaints and CSAT

SSMC summary

4.135 In the SSMC, we also asked for views on how we can better understand the relationship between customer satisfaction and complaints volumes, and whether accounting for this could improve the customer service provided by the GDNs.

Summary of consultation responses

4.136 One GDN proposed an additional incentive to be applied where a GDN achieves both high customer satisfaction and a low volume of complaints. It said that this would encourage the GDNs to consider the relationship between complaints and CSAT, providing more insights and a better understanding of how to further improve customer service.

4.137 However, two electricity network companies disagreed with linking CSAT and complaints. One stated that there could be some relationship between complaints and the CSAT surveys, but a key difference is that not all customers are surveyed under the CSAT ODI-F. The other considered linking the CSAT and Complaints Metric ODI-Fs could penalise GDNs twice for the same performance as a customer making a complaint is likely to provide a lower score if responding to a CSAT survey.

SSMD decision and rationale

4.138 We have decided not to adapt the Complaints Metric ODI-F design, or introduce an additional ODI-F, to account for a link between the Complaints Metric and CSAT ODI-F scores as we consider this could double count the same information through the two ODI-Fs.

Guaranteed Standards of Performance (GSOPs)

SSMC summary

4.139 The GSOPs are a set of common minimum performance standards for interruptions, connections, and customer service. If the GSOPs are not met, the GDN will make a payment to the customer(s) to acknowledge the inconvenience customers have experienced as a result of the standard not being met.

4.140 In our SSMC, we did not propose to amend the GSOPs as they were recently updated as part of RIIO-GD2, with payment levels increased and associated caps now linked to inflation (CPIH). However, we stated that we would consider

amending the GSOPs if we determined there to be clear consumer benefits. We also noted that the GSOPs can be updated outside of the price control process.

Summary of consultation responses

4.141 All four GDNs were generally supportive of maintaining the GSOPs in their current form. One GDN recommended a full review of the GSOPs during RIIO-GD3 for implementation at the start of RIIO-GD4. It wanted greater data sharing to improve GSOP management and customers' service journey.

4.142 Two GDNs requested we provide further clarity on when payments can be stopped for GSOPs that do not have a payment cap. To support this, one GDN suggested that Ofgem completes and publishes a GSOPs guidance document. The other GDN requested a fixed payment cap for GSOP 1 (failure to supply gas) as it said that not having a cap can create a perverse incentive for customers not to engage with attempts to restore the gas supply, which can lead to excessive pay-outs.

4.143 A consumer group suggested we consider a penalty-only ODI-F to penalise GDNs which do not make payments to customers, based on a target performance score for all GSOPs. It said that the GDNs' performance in this respect is lower and more variable than that of DNOs. It also suggested that the RRPs should include information on the number and value of missed payments, and that we should undertake data quality checks to ensure consistency of GSOP interpretation and reporting.

4.144 One GDN recommended removing the Overall Standards of Service (OSOS) related to connections ahead of RIIO-GD3. The OSOS is an LO which requires the GDNs to take certain actions across connections, alterations and disconnections within specified timeframes at least 90% of the time.[43] The GDN was concerned that it could be subject to enforcement action if the standards are not met in a small number of cases once the number of gas connections decline beyond a certain number.

SSMD decision and rationale

4.145 We have decided to retain the current GSOPs in RIIO-GD3. We consider these to be fit for purpose, with inflation-linked payments and caps to protect consumers. We will consider reviewing the GSOPs ahead of RIIO-GD4. We consider it vital

[43] The OSOS is part of Standard Special Condition D10: Quality of service standards.

that consumers can access and understand the GSOPs that are available to them. Therefore, the GDNs should ensure that an accessible list of the GSOPs (including up to date payment levels and payment caps) and information on how to make a claim, is available on their websites. As part of their RRPs, we will require the GDNs to confirm, each year, that the GSOP information available on their website has been updated.

4.146 We developed a draft GSOP guidance document in 2021. We will review and update this guidance with a view to publishing this ahead of RIIO-GD3. In the meantime, we consider GDNs have adequate protection through their discretion to stop payments where they have taken all reasonable steps to restore supply.

4.147 We will not introduce a penalty-only ODI-F associated with GSOP payments as we think this could already be reflected in the Customer Satisfaction and Complaints incentives. Where customers need to make a claim to the GDN for payments under some standards, these payments should be made as soon as reasonably practicable when a GDN fails to meet a standard. We acknowledge the comment that better data sharing could improve the management of GSOP payments and we remain open to exploring opportunities to improve customers' service journey.

4.148 We will require the GDNs to report the number and value of missed GSOP payments in the RRPs, with an explanation of why these payments have not been made. We will consider reporting this information through the RIIO annual report databook to ensure that stakeholders can understand and hold GDNs accountable for their performance against the GSOPs. We note that there could be legitimate reasons for payments not being made, including issues relating to customer data access. Nevertheless, we want to monitor this to understand the drivers of the GDNs' performance. We note that the licence requires the GDNs to take reasonable steps to validate data provided to us through the RRPs, which we review upon receipt, so we do not consider further data quality checks are required.

4.149 We have decided not to make any changes to the OSOS. The OSOS covers multiple areas, so even if domestic connection numbers decline, it is not clear that this metric would become statistically unreliable or that achieving the targets 90% of the time would become harder.

Unplanned Interruptions ODI-F

4.150 Unplanned interruptions occur when a fault on the network (eg a gas escape) causes the gas supply to be cut off without warning to customers. All gas customers can experience delays in supply restoration following unplanned

interruptions. However, the placement of riser pipes in blocks of flats (multiple occupancy buildings or MOBs) can complicate and make supply restoration particularly difficult during unplanned MOB interruptions.

4.151 We established the Unplanned Interruptions ODI-F in RIIO-GD2 to focus on average restoration times during an unplanned interruption and to ensure the GDNs' performance does not deteriorate. The incentive is a penalty-only ODI-F.

4.152 During RIIO-GD1, the average restoration time for unplanned interruptions in Cadent's North London MOBs increased significantly, so we put in place separate MOB and non-MOB ODI-F targets for its networks.

4.153 We decided to set a single ODI covering both MOBs and non-MOBs for SGN, WWU and NGN as they have fewer MOBs and there was no evidence to suggest a deterioration in their performance. We also noted that work was needed on their systems and processes before MOB interruptions could easily be reported separately.

ODI-F design

SSMC summary

4.154 In our SSMC, we proposed to retain the Unplanned Interruptions ODI-F. We also proposed to:

- continue excluding major incidents from the performance measure;[44] and
- keep the requirement for GDNs that breach the excessive deterioration level (EDL) to submit an explanatory report on the cause and its subsequent actions to improve performance.[45]

4.155 We identified three options for RIIO-GD3:

- Option 1: retain the RIIO-GD2 ODI-F design, where Cadent is the only GDN to have separate performance measures for MOBs and non-MOBs.
- Option 2: introduce separate MOB and non-MOB performance measures for all GDNs.
- Option 3: separate MOB and non-MOB performance measures for Cadent and SGN but retain a single ODI-F for NGN and WWU.

[44] A major incident refers to the loss of supply to more than 250 customers following a single incident.
[45] The EDL is the point at which the maximum penalty through the ODI-F is incurred.

4.156 Option 3 was our preferred approach. We proposed introducing separate performance measures for SGN as it has a longer average annual duration of MOB interruptions in RIIO-GD2 to date, relative to NGN and WWU. It also has a relatively high number of MOB interruptions in its Southern network. We did not consider it proportionate to introduce separate ODI-Fs for NGN and WWU as they are reporting a low number and duration of unplanned MOB interruptions to date in RIIO-GD2 and have relatively few MOBs on their networks.

Summary of consultation responses

4.157 The majority of the respondents were supportive of retaining this ODI-F in some form, although two GDNs stated that it duplicates GSOP1.[46] Some stakeholders raised concerns about the increases of total and average duration of unplanned interruptions in RIIO-GD2 and suggested that this be monitored.

4.158 One GDN agreed with our proposals to continue excluding major incidents from the ODI-F and to retain the requirement to submit a report if the EDL is breached. Other respondents did not comment on this. A consumer group suggested that threshold for the number of customers affected for an unplanned interruption to be considered a major incident (250+) should be assessed for RIIO-GD3, to consider whether it remains appropriate. One GDN proposed that if a GDN reports a significant MOB outage, it could provide a report detailing its response. It suggested that we could use our discretion to rescind penalties where a GDN has justified, through its report, that it has exhausted all efforts. The GDN did not specify whether it was referring to a significant MOB outage over the minimum performance level (MPL) or EDL.

4.159 Stakeholders had differing views on the options we identified for implementing a common or separate MOB and non-MOB performance measures: three stakeholders (including WWU) did not state a preferred option; two stakeholders (including NGN) supported option 2 as they said that a single MOB incident could distort a GDNs' overall performance; two stakeholders supported option 3; and one GDN was impartial on either option 2 or 3.

SSMD decision and rationale

4.160 We have decided to retain the Unplanned Interruptions ODI-F in RIIO-GD3. This will continue to provide the GDNs with a strong incentive to keep average

[46] GSOP1 is a minimum performance standard for GDNs to restore gas supplies within 24 hours following an unplanned interruption. If the standard is not met, GDNs make a payment to affected customers for every 24-hour period the interruption continues.

restoration times for unplanned interruptions as low as possible and to ensure that performance in this area does not deteriorate.

4.161 We will continue to exclude major incidents from the performance measure to avoid penalising the GDNs for incidents that are particularly difficult to manage. We will not change the definition of a major incident as this is an established term linking to multiple areas, including GSOP3. However, we encourage the GDNs to work alongside their ISGs to review whether their practices to mitigate and manage major incidents remain appropriate outside of the RIIO-3 process.

4.162 In addition, we will retain the requirement for the GDNs to submit an explanatory report if they breach the EDL, detailing the cause of the deterioration and subsequent actions to improve performance. We do not consider there to be a need for additional reporting for significant MOB outages as we will already receive reports for MOB outages that exceed a GDN's EDL, and in the event of a major incident. We also think using our discretion to rescind penalties would create a greater resource burden, weaken the ODI-F, and may not encourage the GDNs to develop appropriate proactive and reactive measures to mitigate against unplanned interruptions and reduce their duration.

4.163 We have decided to adopt option 2 to separate non-MOB and MOB measures for all GDNs. While this was not the preferred option in our SSMC, we think this approach will provide a consistent and comparable measure of the GDNs' unplanned interruption performance. We think comparability amongst the GDNs will enable us to understand whether MOB interruptions are based on factors within the GDNs' control (eg best practices and resource) or due to external factors (eg getting permission from local authorities). Although we said at SSMC that option 2 may not be proportionate for NGN and WWU due to the small number of MOBs on their networks, in their responses NGN supported option 2 and WWU did not have a preferred option. We therefore consider option 2 is preferable to provide consistency and better visibility of performance across the GDNs.

4.164 We will set the incentive collar at the equivalent bps of RoRE for each performance measure (ie non-MOB and MOB) to the 0.25% of base revenue collar used for Cadent's RIIO-GD2 ODI-Fs. We think it is appropriate to distribute the incentive equally between the non-MOB and MOB measures because MOB interruptions are likely to have a bigger impact on consumers, but there are a greater number of non-MOB interruptions.

Performance level

SSMC summary

4.165 We asked for stakeholders' views on how to update the MPL[47] and EDL for RIIO-GD3. Potential options were to:

- require the GDNs to work alongside their ISGs to propose MPLs and EDLs in their business plans;
- set performance levels based on the highest annual average duration from the first four years of RIIO-GD2;
- set performance levels based on the highest annual average duration from RIIO-GD1 and the first four years of RIIO-GD2 (noting that we do not have separate data for MOBs and non-MOBs in RIIO-GD1 for NGN, SGN nor WWU); or
- retain RIIO-GD2 performance levels if we do not change the incentive design from the RIIO-GD2 approach.

Summary of consultation responses

4.166 The majority of respondents said that targets should be based on regional network-specific data to account for regional differences. One GDN proposed that common targets should be set for non-MOBs across all GDNs as performance should be similar and customers should receive the same level of service across all the networks.

4.167 Two GDNs provided views on RIIO-GD3 target setting. One GDN suggested that its targets should remain the same as in RIIO-GD2 because these were set at an appropriate level to protect customers against deterioration of performance and were supported by customers. Another suggested that the GDNs work alongside their ISGs to propose targets.

SSMD decision and rationale

Non-MOB performance levels

4.168 We have decided to introduce common industry targets for non-MOBs. While this approach does not account for regional differences, we do not consider non-MOB unplanned interruptions to be as complicated to restore as MOB unplanned interruptions, and the mitigations are similar across the GDNs. We therefore

[47] The MPL is the point at which a penalty will be incurred under the ODI-F.

consider that a common non-MOB target is appropriate. As shown in Figure 2, the GDNs' highest annual average duration for non-MOBs have been similar across all the GDNs in the first two years of RIIO-2, despite having different MPLs (see Table 2).

Figure 2: Highest annual average duration in first two years of RIIO-2

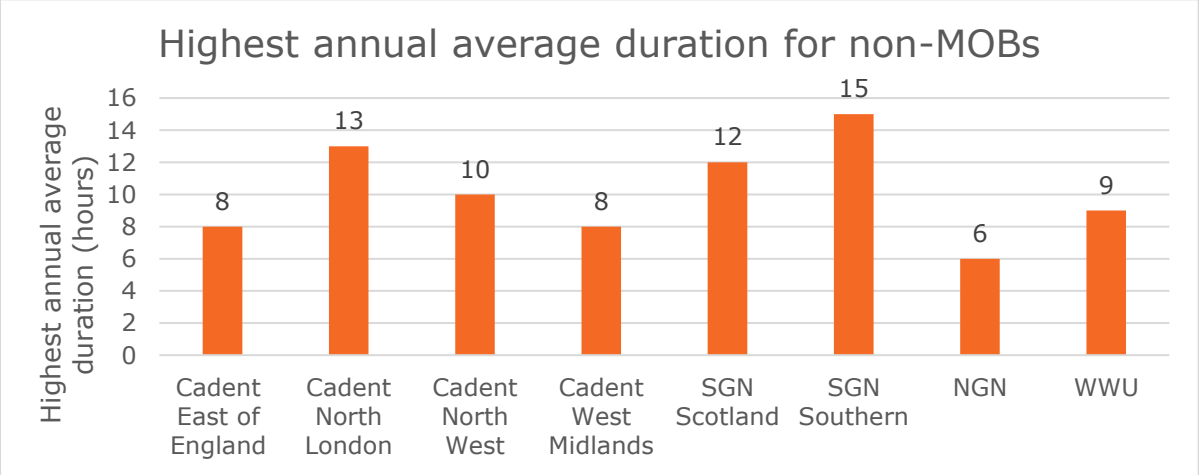

Table 2: RIIO-GD2 MPLs for average annual duration (in hours) for non-MOB unplanned interruptions

	Cadent East of England	**Cadent North London**	**Cadent North West**	**Cadent West Midlands**	**SGN Scotland**	**SGN Southern**	**NGN**	**WWU**
MPL	5	13	9	8	29*	26*	6*	9*

*RIIO-2 MPLs are combined for non-MOBs and MOBs.

4.169 We want the GDNs to work alongside their ISGs to propose reasonable common industry targets for non-MOB MPLs and EDLs in their business plans. We expect the GDNs and their ISGs to use data from the first three years of RIIO-GD2, including from other networks, when developing the proposed industry targets. The GDNs are expected to explain how they developed the proposed common targets and justify why they think these are appropriate. The explanation should include analysis based on the unplanned interruptions data provided in the RRPs. We will consider the proposed targets and consult on the common targets at Draft Determinations.

MOB performance level

4.170 We have decided that each GDN should work alongside its ISG to propose and justify MPLs and EDLs for unplanned MOB interruptions for its network(s) within its business plan. This will enable each GDN to develop targets that have been tested with their ISGs and through stakeholder engagement to reflect its

customers' expectations and account for differences in the number and types of MOBs on each network. We expect the proposed MPL and EDL targets to be well justified and to use RRP data from the first three years of RIIO-GD2. We will consult on the targets at Draft Determinations.

Collaborative Streetworks ODI-F (Cadent North London & East of England and SGN Southern only)

4.171 The RIIO-GD2 Collaborative Streetworks ODI-F was created to incentivise SGN and Cadent to carry out collaborative projects with other utilities when undertaking streetworks in their Greater London networks. These collaborative projects are facilitated by the Greater London Authority (GLA). The reward-only ODI-F seeks to reduce the frequency and duration of streetworks and promote knowledge sharing across utilities. In RIIO-ED2, we created a similar collaborative streetworks incentive for UKPN's London network.

4.172 Under the ODI-F, SGN and Cadent receive a reward of £0.305m per completed collaborative streetwork that meets the following eligibility criteria:[48]

- it is 0.2km minimum length;
- it is level 2 collaboration at a minimum;[49]
- it is fulfilled by a minimum of two collaborating utilities;
- it is a permanent solution, not a temporary fix; and
- it is completed by the end of RIIO-GD2.

ODI-F design

SSMC summary

4.173 In our SSMC, we proposed to retain the reward-only ODI-F for networks in Greater London, with a cap of 0.5% of base revenue.[50] We proposed not to expand the incentive outside of Greater London as stakeholders had highlighted that a central co-ordinator is important to oversee collaborations, similar to the role of the GLA in the RIIO-2 ODI-F, and it was not clear who would undertake this role outside of London. However, we welcomed evidence from stakeholders

[48] The RIIO-GD2 collaborative streetwork incentive rewards GDNs that undertake projects that fall within the minimum criteria of the incentive or projects that are identified as strategic by the GLA.
[49] As defined in the GLA collaboration manual.
[50] SSMC GD annex, Chapter 4, paragraph 4.94-4.95, page 63: https://www.ofgem.gov.uk/consultation/riio-3-sector-specific-methodology-gas-distribution-gas-transmission-and-electricity-transmission-sectors

as to whether third parties would be willing, able and appropriate to undertake a co-ordinator role outside of London.

Summary of consultation responses

4.174 All respondents supported retaining the Collaborative Streetworks ODI-F. One GDN stated that the road length requirement for qualifying projects should be replaced with a requirement based on the density of a population or the density of traffic. Another stakeholder supported the GDNs coordinating repex-related activities with other streetworks projects, such as heat networks.

4.175 We received two suggestions regarding the incentive cap. One GDN suggested that it should be set over the price control period instead of annually. Another GDN suggested increasing the cap to encourage more collaboration.

4.176 All GDNs supported the expansion of the ODI-F across GB as they said that an expansion would provide wider social and consumer benefits. Other stakeholders did not comment on this.

4.177 One GDN proposed that we could reward projects that meet a minimum requirement outside of major cities, removing the need for a third-party co-ordinator. Another GDN suggested that it could lead co-ordination within its regional utilities and could take projects to its highway authorities. However, a third GDN stated that a third party or local authority is crucial to oversee the co-ordination of projects. The fourth GDN stated that key stakeholders within its region had taken an interest in the expansion of the incentive but did not provide evidence that these stakeholders are willing, able and appropriate to take on a coordination role.

SSMD decision and rationale

4.178 We have decided to retain the ODI-F with a cap of the equivalent bps of RoRE to the RIIO-GD2 cap of 0.5% of base revenue. The cap has not been met consistently by Cadent and SGN in RIIO-GD2 to date, so we have not seen evidence that it is limiting collaboration. It is also in line with other ODI-Fs. The cap will be set over the five-year RIIO-GD3 period to provide more flexibility and to recognise projects that may not be completed within a calendar year.

4.179 We plan to work with the GLA and GDNs to assess whether the project eligibility criteria needs to be updated and will set them out in our Draft Determinations.

4.180 We have also decided not to expand the incentive outside of Greater London. We think it is important for there to be a central coordinator who can oversee the collaborative projects that are rewarded through the ODI-F, similar to the role of

the GLA. This third party is needed to monitor progress across utilities, help drive collaboration, and define where projects are strategic to be eligible for a reward within their regions. We do not think this role can be delivered by a GDN. We have not been able to clearly identify any third parties who are willing, able and suitable to deliver this role outside of Greater London.

Incentive rate

SSMC summary

4.181 We set out two options for setting the incentive rate:[51]

- Option 1: retain a flat reward per collaborative project delivered, updated to take account of the social value delivered by projects under the RIIO-GD2 incentive; and
- Option 2: set a dynamic incentive rate based on the social benefits of the individual projects, eg using the number of days saved measured by the GLA's Monitoring and Evaluation (M&E) tool.[52]

Summary of consultation responses

4.182 There were mixed views from stakeholders on the incentive rate design. Three GDNs supported a flat incentive rate as it is simple to implement, especially if the ODI-F was expanded across GB. A consumer group stated that a dynamic incentive rate will add little additional value to consumers in comparison to a flat incentive rate as the GLA and other utilities have an influence on projects that are required.

4.183 One GDN suggested that we implement both dynamic and flat incentive rates based on local authority appetite and level of engagement.

4.184 Another GDN suggested alternative options to:

- set incentive rate bands based on value eg the number of days saved, the type of projects delivered, or the level of collaboration; and
- set the incentive rate based on the number of days saved and then scaled to the traffic and/or population density of an area.

[51] SSMC GD annex, Chapter 4, paragraph 4.96-4.97, page 63: https://www.ofgem.gov.uk/consultation/riio-3-sector-specific-methodology-gas-distribution-gas-transmission-and-electricity-transmission-sectors

[52] The GLA developed the M&E tool to produce a consistent measure of the value and benefits that collaborative streetworks generate: https://www.london.gov.uk/programmes-strategies/better-infrastructure/infrastructure-coordination/streets-service/performance-and-results

4.185 The GDN noted that a third party would be required to oversee, calculate, and award rewards for these options.

SSMD decision and rationale

4.186 We have decided to implement incentive rate bands based on the complexity and social value of a project - ie GDNs will receive a higher incentive rate for projects that are above a value threshold. Within each band, we will set a flat incentive rate. This will incentivise the GDNs to focus on more complicated collaboration projects with higher social benefits. It also reflects that we expect less complicated collaboration projects to transition to BAU over time. We will work with the GLA and other stakeholders ahead of our Draft Determinations to determine how to set the incentive band thresholds and appropriate incentive rates for each band. The GLA are updating their M&E tool this year, so we will consider how to incorporate any changes into setting the incentive bands and rate.

New Large Load Connections Re-opener

SSMC summary

4.187 The New Large Load Connections Re-opener enables the GDNs to recover costs incurred from network reinforcements required by new large industrial loads, eg power stations and distilleries.

4.188 In our SSMC, we sought views from stakeholders as to whether the New Large Load Connections Re-opener should be retained in RIIO-GD3.

Summary of consultation responses

4.189 All five respondents stated that the re-opener should be retained in RIIO-GD3 as uncertainties will remain. Some stakeholders said that work in this area is largely driven by customers and influenced by policy decisions, so the cost, size and number of connections remain uncertain and difficult to forecast.

4.190 One GDN suggested merging the New Large Load Connections Re-opener with other re-openers to create a broader mechanism, which it said would simplify the re-opener process.

4.191 One GDN suggested that the current definition of a large load connection for offtaking gas[53] should be updated in RIIO-GD3 to account for potential changes in Scottish Government policy.[54] It stated that these potential changes could lead to more small-scale peaking plants wanting to connect, which could be located locally at housing developments connections. It suggested that expanding the uncertainty mechanism to include these connections would protect the network against uncertainties in costs associated with increasing capacity.

4.192 A stakeholder also suggested that the re-opener may also be required to facilitate hydrogen connections if the government decides to implement hydrogen blending.

SSMD decision and rationale

4.193 We will retain this mechanism for RIIO-GD3 to account for uncertainties in costs, number and size of connections at the time of setting the price control.

4.194 We have decided to retain the RIIO-GD2 scope, including retaining the demand threshold within the definition of large load connection for offtaking gas. The current scope reflects that the re-opener was established to account for large load connections that require network reinforcement, so we do not think it is appropriate to reduce the demand threshold. It is not clear what the potential impact of the Scottish Government's policy will be on the network, but we will consider if we need to introduce or amend any mechanisms to account for this if there is more clarity ahead of setting our Final Determinations. We also consider that hydrogen connections requiring reinforcement could be facilitated through this mechanism.

Specified Streetworks Costs Re-opener

SSMC summary

4.195 The Specified Streetworks Costs Re-opener enables the GDNs to recover efficient costs associated with new permit and lane rental schemes.

[53] In RIIO-GD2 this is defined as an offtake connection with a maximum offtake capacity in excess of 1500 standard cubic metres per hour, which is subject to the Economic Test.
[54] For further information, please see Scotland's Electricity Infrastructure: Inhibitor or enabler of our energy ambitions?: https://digitalpublications.parliament.scot/Committees/Report/NZET/2023/9/12/00145e0a-634b-4e93-87f7-cb412979e0d6-2#dadada8a-0b1b-4a96-bf16-0b35b1c665a2.dita

4.196 In our SSMC, we sought views from stakeholders as to whether the Specified Streetworks Costs Re-opener should be retained in RIIO-GD3.

Summary of consultation responses

4.197 All respondents agreed that the re-opener is required in RIIO-GD3 as legal and policy changes will create uncertainties in costs for GDNs. Some stakeholders also highlighted that the UM was retained for RIIO-ED2. Examples of uncertainties that were raised by respondents include:

- the Department for Transport (DfT) plans to onboard ten highway authorities a year;
- the Department for Business and Trade recommendation that all highway authorities move to a lane rental system;
- the DfT recently consulted on streetworks legislation reform;[55] and
- changes in the Environment Agency's requirements around waste management, which could require GDNs to carry out additional activities associated with excavations.

SSMD decision and rationale

4.198 We have decided to retain this mechanism for RIIO-GD3. We plan to work alongside the GDNs during the licence drafting process to ensure the scope of the re-opener reflects where appropriate the uncertainties raised, including costs associated with changes to the EA's requirements on waste management.

Removed RIIO-GD2 outputs and uncertainty mechanisms

Fuel Poor Network Extension Scheme (FPNES) volume driver and ODI-R

SSMC summary

4.199 The FPNES was created to help off-grid, fuel poor households connect to the gas network by providing funding towards the cost of the connection.

[55] For further information, please see Streetworks: fines and lane rental surplus funds: https://www.gov.uk/government/consultations/street-works-fines-and-lane-rental-surplus-funds

4.200 We retained the FPNES in RIIO-GD2 due to the immediate benefits the scheme could provide to fuel poor households. However, since setting RIIO-GD2, the number of FPNES connections has reduced significantly.[56] A key factor in this decrease is the increasingly limited government and local authority funding for First Time gas Central Heating (FTCH) systems, which are required to enable FPNES connections.

4.201 In our SSMC, we proposed to remove the FPNES in RIIO-GD3 as the limited funding available for FTCH systems has restricted the use of the scheme and we are not aware of new funding sources becoming available. We said that, due to the limited number of FPNES connections, we do not consider that the administration costs will be proportionate to the consumer benefit of continuing the scheme. We were also mindful of the risks in connecting additional fuel poor households to the gas network and facilitating the installation of natural gas central heating systems while there is uncertainty around the future of gas.

Summary of consultation responses

4.202 All respondents supported the removal of the FPNES from RIIO-GD3. They highlighted the lack of devolved government and local authority funding for FTCH systems, the need to decarbonise heat to meet net zero, and the potential for gas regulatory depreciation charges to increase.[57]

4.203 Some stakeholders stated that removing the FPNES would reduce the overall support available for consumers in vulnerable situations in RIIO-GD3, so recommended the VCMA's size and scope should be increased. Three GDNs supported maintaining the ability to connect a small number of fuel poor households to the gas network through the VCMA. They suggested using 'future proofed' measures such as installing pipework and radiators which can be converted for use with a heat pump. A consumer group suggested that if FPNES funds are reallocated to the VCMA, the VCMA Governance Document should be updated to specify a minimum proportion of total funding be spent on fuel poverty projects.

[56] While the FPNES remains open in RIIO-GD2, in July 2023, we decided to repurpose £111m of unspent FPNES funds to support consumers in vulnerable situations through the VCMA.
[57] See Chapter 4 of the Overview Document and Chapter 9 of the Finance Annex.

SSMD decision and rationale

4.204 We have decided to remove the FPNES from RIIO-GD3 for the reasons outlined in the SSMC.

4.205 Please see paragraphs 4.49-4.51 58for our decision on setting the level of VCMA funding. While £111m of unspent FPNES funds in RIIO-GD2 were repurposed for the VCMA, the funding for these mechanisms are not directly linked. However, we will consider the overall provision of support for consumers in vulnerable situations when setting the level of VCMA funding. We do not consider it necessary to ringfence funding for issues of fuel poverty as we already require the GDNs to tailor their VCMA projects to the needs of their customers in line with their Vulnerability Strategies.

4.206 We do not consider it appropriate for the VCMA to be expanded to include gas connections for consumers in vulnerable situations. We are unconvinced that this approach would significantly reduce the administrative costs currently associated with the FPNES. It also does not resolve the issue of increasingly limited funding available for FTCH systems nor that this falls outside the role and remit of GDNs. We are also mindful of the risks posed by connecting consumers in vulnerable situations to the gas network given its uncertain future. The GDNs should, instead, prioritise alternative ways to support these consumers, including through their use of the VCMA.

Consumer Vulnerability ODI-R

4.207 In RIIO-GD2, the Consumer Vulnerability ODI-R requires the GDNs to host an annual showcase event, and mandates six common reporting metrics to highlight GDN performance relating to consumers in vulnerable situations and CO awareness.

ODI-R reporting metrics

SSMC summary

4.208 In the SSMC, we considered that some of the six metrics will not remain relevant beyond RIIO-GD2. Therefore, we proposed to remove the ODI-R as a separate metric and remove or combine the existing metrics with other reporting metrics, as outlined in Table 3 below.

Table 3: Consumer Vulnerability ODI-R RIIO-GD2 reporting metrics and SSMC proposals

ODI-R theme	RIIO-GD2 metrics	SSMC proposals for RIIO-GD3
PSR	i. Average Customer Satisfaction for PSR customers.	Report PSR Customer Satisfaction metric as part of the Customer Satisfaction survey ODI-F reporting through the RRPs.
FPNES	i. Number of FPNES connections; ii. Percentage of the company-specific FPNES target delivered; ii. Percentage of FPNES connections delivered compared to the volume driver cap.	Remove the reporting metric if FPNES is removed from RIIO-GD3.
CO Awareness	i. Average CO awareness score via a common survey; ii. Number of consumers reached through CO awareness sessions.	Report through the GDNs' VCMA Annual Reports.

Summary of consultation responses

4.209 All respondents supported our SSMC proposals to remove the separate Consumer Vulnerability ODI-R and relocate the remaining reporting metrics. They considered this would streamline reporting and make it easier for stakeholders to access the information. One stakeholder encouraged greater data standardisation.

SSMD decision and rationale

4.210 We will remove the separate Consumer Vulnerability ODI-R in RIIO-GD3 and relocate, or remove, the remaining relevant metrics.

4.211 As outlined in paragraphs 4.99 and 4.134, we will introduce a separate PSR Customer Satisfaction ODI-R and PSR Customer Complaints ODI-R. Publishing this data will ensure transparency and accountability, with information published in an accessible format to ensure comparability.

4.212 As a result of our decision to remove the FPNES in paragraph 4.204, we will remove the three reporting metrics associated with the scheme.

4.213 We will remove the two CO awareness metrics as an ODI-R but will revise the VCMA Governance to require GDNs to report on these in their VCMA Annual Reports.

Vulnerability event

SSMC summary

4.214 The annual vulnerability event, which currently forms part of the ODI-R,is incorporated into the VCMA Governance Document. The GDNs are required to collectively organise an annual showcase event to highlight key project outcomes and share ideas.

4.215 In the SSMC, we proposed to remove the separate ODI-R for the vulnerability showcase event but said that we would retain the requirement as part of the VCMA Governance Document. We also sought views on how the annual VCMA event could be improved to further harness the collaborative sharing of ideas, opportunities, learnings and best practice with diverse stakeholders.

Summary of consultation responses

4.216 Most stakeholders supported retaining the annual VCMA showcase event. They said that it provides an inclusive opportunity to share high-level insights into VCMA projects and their impact. Respondents also stated that the event is an effective way to facilitate collaboration and share best practices with a wide range of stakeholders. They recommended continuing to collate and incorporate feedback from each event to further develop its impact. One respondent encouraged greater focus on assessing the feasibility of scaling up successful individual projects, while another was keen to use the event to hear more from those supported through VCMA projects. One stakeholder highlighted the benefits of continuing to host the event online, including in enabling greater accessibility, increasing reach, and reducing the burden on participants.

4.217 One GDN suggested that the event becomes biennial. It said that an annual event could become repetitive, given that the GDNs' core obligations do not change significantly year-to-year and projects are likely to roll over from RIIO-GD2 to RIIO-GD3.

4.218 Some responses noted that the annual event provides limited opportunity to fully critique individual projects, with one stakeholder suggesting that the sharing of challenges and learnings might be more effectively discussed in a closed, slimmed-down forum. To improve transparency and accountability, another stakeholder proposed including additional detail within VCMA reports to evidence changes made to projects as a result of stakeholder feedback. Stakeholders also emphasised the importance of regular, timely, and robust feedback on VCMA projects beyond the parameters of the annual event.

SSMD decision and rationale

4.219 We have decided to retain the requirement for GDNs to host an annual vulnerability event as part of the VCMA Governance, rather than as an ODI-R. The GDNs should ensure these events continue to platform and engage diverse stakeholders connected with vulnerability issues, both within and beyond the sector. The GDNs should further develop the event using stakeholder feedback to deepen collaboration, share best practice, and identify collective responses to emerging challenges. Given our decision to consider funding some BAU vulnerability activities within baseline allowances (see paragraph 4.40), we consider it appropriate for the annual vulnerability event to include both VCMA and BAU vulnerability activities.

4.220 We will also revise the VCMA Governance Document ahead of RIIO-GD3. As part of this, we will consider updating the requirements of the annual showcase event and whether to require GDNs to include reporting on what changes have been made to projects based on stakeholder feedback.

Domestic Load Connections Allowance (DLCA)

SSMC summary

4.221 The DLCA is the contribution the gas distribution price control provides towards the cost of installing gas connections from the main to a domestic premise. This socialises the cost of laying the first 10m of pipe in public land,[58] and is set out in the Gas Transporter Licence.[59]

4.222 Use of the DLCA is declining as the number of new gas connections is decreasing. This downward trend is expected to continue as consumers move to low carbon technologies to support decarbonisation.

4.223 We proposed to remove the DLCA in our SSMC. Under this proposal, customers could still request and receive new gas connections to domestic premises located within 23 metres of a main, but the subsidy for the related costs would be removed.

[58] To benefit from the DLCA, connections must be for properties that are wholly or mainly used for domestic purposes and are located within 23m of a relevant main. The DLCA does not apply where customers receive the FPNES.
[59] Standard Condition 4B: 'Connection Charging Methodology', Gas Transporter licence, paragraph 1.

Summary of consultation responses

4.224 Most responses to the proposal were neutral or positive. One stakeholder supported removing the DLCA because it conflicts with government net zero targets and goals to phase out fossil fuel subsidies. Another stakeholder supported its removal as it distorts competition with clean technologies.

4.225 All GDNs said that the removal of the DLCA would increase the cost of a new domestic gas connection for customers and highlighted this as a concern for vulnerable consumers. One GDN disagreed with removing the DLCA, asserting that it would be premature to remove it before pending government policy decisions are made, including on heat.

4.226 Another GDN commented that removal of the DLCA would require an amendment to the Gas Transporter Licence and potentially a change to the Gas Act 1986.

SSMD decision and rationale

4.227 We have decided to remove the DLCA. This will mean that all domestic connection costs will be chargeable to the individual consumer requesting the connection. While a GDN suggested that an amendment to the Gas Act 1986 may be needed to achieve this, we think that modifying the Gas Transporter licence is sufficient because the DLCA policy only sits within the licence itself.

4.228 While the government has not yet issued decisions on heat policy, we think that this change aligns with its ambitions to phase out fossil fuel subsidies and achieve net zero targets. Following the joint review of gas distribution network charges initiated by DESNZ and Ofgem in July 2023,[60] DESNZ have confirmed to us that they are supportive of our decision as it will facilitate more effective competition among low carbon energy options and natural gas. We also see a logic in removing a subsidy that encourages domestic consumers to connect to the gas grid when the future of the network is uncertain. While this decision will increase the connection cost to an individual consumer, we think that subsidising new gas connections creates a risk of future disruption and expense. To support consumers in vulnerable situations there are government programmes designed

[60] Delivering a Better Energy Retail Market policy paper: https://www.gov.uk/government/publications/delivering-a-better-energy-retail-market

to help alleviate fuel poverty, including support for the electrification of heat and other energy saving improvements.[61]

Domestic Connections Volume Driver (DCVD)

SSMC summary

4.229 In RIIO-GD2, we introduced the DCVD to provide the GDNs with funding for portion of connection costs that are recovered through RIIO - including costs relating to the DLCA. The volume driver covers new and existing domestic service connections.[62]

4.230 Consistent with our SSMC proposal to remove the DLCA, we proposed to remove the DCVD and instead provide funding through baseline allowances.

Summary of consultation responses

4.231 Consultation responses were mixed. Three GDNs and another stakeholder generally supported removal if the DLCA is also removed. One GDN suggested that if legislative change is required to remove the DLCA, then the DCVD should remain in effect until that change occurs. If the DCVD is retained, it also proposed reviewing the underlying methodology.

4.232 Another GDN acknowledged that some elements could be moved into baseline allowances, but suggested that uncertainty in wider connections volumes justifies the retention of the DCVD to ensure funding relates to completed connection volumes. A consumer group noted that retaining a method to claw back costs for connection volumes is important.

4.233 Two GDNs commented that because they expect acceptance rates for domestic connections quotations would be lower following the removal of the DLCA, consideration should be made for a method of recovering fixed overhead costs, including quotations, potentially through baseline allowances.

[61] For example, in England and Wales there is the Boiler Upgrade Scheme(https://www.find-government-grants.service.gov.uk/grants/boiler-upgrade-scheme-1#summary) and in Scotland there are grants and energy saving improvements (https://www.mygov.scot/energy-saving-grants). In Great Britain, the Energy Company Obligation scheme aims to help alleviate fuel poverty and contribute to carbon reduction targets in the domestic sector (https://assets.publishing.service.gov.uk/media/64787c1cb32b9e0012a96038/energy-company-obligation-eco-guidance-2022-2026.pdf)

[62] RIIO-GD2 FDs, GD Annex, pages 151-152: https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator

SSMD decision and rationale

4.234 We have decided to remove the DCVD. While there will continue to be some new domestic connections in RIIO-GD3, the removal of the DLCA combined with already decreasing volumes in this area, means that we expect to reduce baseline allowances in this area - which will make the calibration of a volume driver in this area disproportionate. While any remaining fixed overhead costs such as quotation costs will be variable, we expect these will be of low materiality and can be managed through baseline allowances.

Disconnections

4.235 We did not consult on disconnections in our SSMC, but several stakeholders raised this in their consultation responses. It is anticipated that the number of disconnections will increase during RIIO-3 as more consumers electrify their heating to meet government targets.

4.236 Several stakeholders raised the issue of potentially rising disconnection costs, and a consumer interest group flagged a lack of clarity around procedural and cost arrangements. One stakeholder said that the charging framework should be modified to allow disconnection costs to be recovered as part of RIIO-GD3 to spread costs between current and future consumers. One GDN also suggested that a new volume driver might be needed for disconnections.

4.237 Wider work in Ofgem is happening to review this area. The review will determine whether regulatory change is needed to the current disconnections charging policy outside of the RIIO-3 process and we will be publishing an open letter on this in due course. If in scope of RIIO-3, some policy changes could progress as part of Draft Determinations. In the meantime, we have incorporated disconnections-related data in the BPDTs to support future decision-making in this area.[63]

Smart Metering Rollout Costs Re-opener

SSMC summary

4.238 The Smart Metering Rollout Costs Re-opener enables the GDNs to recover efficient costs incurred from the smart meter rollout programme.

[63] For more information about disconnection costs, please see the SSMD, Finance annex, paragraphs 10.40 - 10.42.

4.239 In the SSMC, we proposed to remove the Smart Metering Rollout Costs Re-opener as the framework for the smart meter rollout is expected to end on 31st December 2025 and government will assume responsibility for any additional policies in this area.

Summary of consultation responses

4.240 There were mixed views from the GDNs about the proposed removal of the Smart Metering Rollout Costs Re-opener.

4.241 Two GDNs supported the removal of the re-opener, with one adding that the smart meter rollout is not complete and may need to continue into RIIO-GD3, which may cause GDNs to incur intervention costs. It suggested that the GDNs' RIIO-GD2 allowance in this area should continue to support the ongoing rollout. A GDN disagreed with the removal of the re-opener as it said that the rollout has a considerable way to go. It suggested that the re-opener be retained to allow for costs incurred on or after 1st April 2021. One GDN was impartial on whether to removal the re-opener.

SSMD decision and rationale

4.242 We have decided to remove the Smart Metering Rollout Costs Re-opener in RIIO-3. Current government policy remains that suppliers have binding targets to roll out smart meters to remaining customers by the end of 2025, meaning the quantum of smart meter installations in RIIO-GD3 which could incur GDN call outs should be relatively immaterial and forecastable. DESNZ are responsible for smart meter policy and once the new policy framework for smart meters is confirmed for 2026 onwards, that will provide GDNs with further clarity. On this basis we have decided to maintain our SSMC position to remove the re-opener and fund opex costs in this area providing that the GDNs submit and justify costs in their business plans.

Personalising Welfare Facilities PCD (Cadent only)

SSMC summary

4.243 In RIIO-GD2, Cadent has a bespoke PCD to provide additional, personalised welfare facilities (that go beyond the support required through GSOP3) to customers in vulnerable circumstances during supply interruptions.[64]

4.244 In our SSMC we proposed removing this PCD and set out two options for how to continue to fund additional welfare facilities in RIIO-GD3:

- to use the VCMA (our preferred approach); or
- for GDNs to justify costs within their business plans to form part of their baseline allowances.

Summary of consultation responses

4.245 All stakeholders agreed that the Personalising Welfare Facilities PCD should be removed but supported the need for the GDNs to continue to provide additional welfare support in RIIO-GD3. Two GDNs supported the expansion of this area of work to all GDNs.

4.246 However, responses differed on how we should fund this area of work in RIIO-GD3. Three GDNs supported funding additional welfare facilities under the VCMA to create consistency and to reduce regional bias. Two stakeholders suggested that BAU work should be funded through baseline allowances.

SSMD decision and rationale

4.247 We have decided to remove the Personalising Welfare Facilities PCD as this area of work has now become BAU for Cadent. We also consider that this area of work should not be bespoke to Cadent and additional, personalised welfare facilities could be provided by all the GDNs.

4.248 We have decided that that additional welfare facilities can be funded through baseline allowances, providing that the GDNs submit and justify costs for this in their business plans. We have decided to allow some BAU vulnerability activities to be funded through baseline allowances (paragraph 4.57-4.59) and we think additional welfare facilities should be part of this.

[64] GSOP3 ensures the provision of facilities during a supply interruption, eg alternative heating, cooking facilities, access to hot water and a hot meal to PSR customers.

4.249 We do not consider it appropriate to fund additional welfare facilities through the VCMA because it is intended to fund work that goes beyond BAU, as set out earlier in this chapter. This will enable the VCMA to be spent on initiatives which proactively respond to specific or emerging issues and enable project growth.

High-rise Building Plans ODI-R (Cadent only)

SSMC summary

4.250 The RIIO-GD2 High-rise Building Plans ODI-R is a bespoke ODI-R for Cadent to produce management plans for high-rise residential buildings that it supplies.

4.251 We proposed to remove Cadent's bespoke ODI-R as Cadent successfully surpassed its year 2 targets across all its networks. We set out that we are satisfied that the creation of high-rise building plans is now part of Cadent's BAU practices.

Summary of consultation responses

4.252 All respondents agreed with our proposals to remove the High-rise Building Plans ODI-R for RIIO-GD3 as the work is now BAU. However, Cadent highlighted that costs will remain in RIIO-GD3 as it was also providing funding for teams to manage stakeholder relationships that are associated with providing good services to customers in RIIO-GD2. It suggested that these costs are funded through baseline allowances and that cost assessment processes should not include comparative benchmarking for high-rise buildings and should be assessed similar to other MOB related expenditures.

4.253 One stakeholder suggested that the planning processes associated with the ODI-R should become BAU for all GDNs if MOB and non-MOB performance measures are separated out for all GDNs under the Unplanned Interruptions ODI-F (discussed earlier in this chapter).

SSMD decision and rationale

4.254 We have decided to remove the High-rise Building Plans ODI-R as we are satisfied that high-rise building plans are now part of Cadent's BAU practices. We expect Cadent, and all GDNs, to continue to have robust management plans for high-rise buildings. These continue to be required as part of HSE regulations and will also help ensure effective GDN management of planned and unplanned

interruptions.[65] The GDNs can submit and justify costs associated with the management of high-rise building in their business plans. We acknowledge Cadent's point on benchmarking and will make a decision on our cost assessment processes for high-rise buildings in our Draft Determination.

[65] For further information please see, managing safety risks in high-rise residential buildings: a detailed guide: https://www.gov.uk/government/publications/building-safety-guides-for-accountable-persons/managing-safety-risks-in-high-rise-residential-buildings-a-detailed-guide

5. Cost of Service

Introduction

5.1 One of our main objectives for RIIO-GD3 is to determine the efficient level of costs that will enable GDNs to carry out their activities and deliver an appropriate level of service for consumers.

5.2 Despite uncertainty in the speed and scale of the decline in gas usage, we think RIIO-GD2 remains the appropriate starting point to develop the cost assessment approach for RIIO-GD3. This is because expenditure is expected to remain largely routine to ensure a safe and resilient network.

5.3 Since the publication of the SSMC, we have conducted eight cost assessment working groups (CAWGs) with the GDNs and other stakeholders, to discuss the development of the Business Plan Data Templates (BPDTs) and the cost assessment approach for RIIO-GD3.

5.4 The ability to interrogate and analyse all the available data (both historical and forecast) is crucial to building a robust toolkit for cost assessment, in line with the principles set out in our SSMC. As such, we will not finalise the cost assessment approach for RIIO-GD3 before final business plan submissions. Nonetheless, we will continue to engage extensively through the CAWGs to develop cost assessment methodologies and tools for all cost areas. In this chapter we provide an update on progress made so far and set the direction of travel for the RIIO-GD3 cost assessment approach for baseline allowances.

RIIO-GD3 Business Plan Data Templates (BPDTs)

5.5 In order to conduct robust cost assessment, it is essential that we have high-quality and consistently reported data. To achieve this, GDNs are required to complete BPDTs based on our guidance documents.

SSMC summary

5.6 In our SSMC, we stated our intention for the RIIO-GD3 BPDTs to be simple and closely aligned with the RRPs. We proposed using both the RIIO-GD2 RRP and BPDT as the starting point, and since issuing the SSMC, we have developed and evolved reporting requirements for RIIO-GD3. We have:

- conducted an initial mapping exercise of the tables and structure of the GD2 RRPs and BPDTs to determine what needed to be retained and removed;

- shared draft RIIO-GD3 templates in batches for iterative development, and used the CAWGs and Gitlab as a forum for collaborative working with the GDNs, resolving over 200 issues raised in the process; and
- developed and updated the BPDT guidance and commentary documents in line with the changes made to the templates.

Summary of consultation responses

5.7 In response to our SSMC, stakeholders commented that the reporting requirements were too complex and resource intensive and this has had an impact on the regulatory burden since RIIO-GD1. They suggested that Ofgem should ensure that the level of reporting and granularity requested for RIIO-GD3 is proportionate. They flagged areas of duplication and issues in the BPDTs, such as legacy reporting structures from RIIO-GD1 and GD2, the interaction between different cost activity tables, and unclear terminology.

SSMD decision and rationale

5.8 A final draft version of the RIIO-GD3 BPDTs and guidance have been published alongside the SSMD.

5.9 We have taken on board the feedback as part our engagement process with the GDNs since issuing the SSMC. We consider that the BPDT and associated guidance have addressed detailed issues and concerns raised by the GDNs and are proportionate to the level of costs that need to be assessed.

5.10 As a next step, GDNs will submit draft business plan data to us on 31st July 2024 which will enable us to test the templates, guidance and processes. Following this, we will continue to work in collaboration with the GDNs, via the CAWGs and Gitlab to resolve any outstanding issues and enhance the templates ahead of final business plan submissions.

Overview of the RIIO-GD2 cost assessment approach

5.11 In RIIO-GD2, we used a variety of methods to assess the GDNs' efficient costs and set baseline allowances. We used regression and non-regression analysis (which allowed for benchmarking), as well as technical assessment where benchmarking was not suitable and costs were company or project specific.

5.12 We used a single top-down totex regression model to assess 86% of forecast costs.[66] Non-regression assessment made up around 8% of total forecast costs and covered a range of individual cost activities including Multiple Occupancy Buildings (MOBs), repex diversions, streetworks and smart metering.

5.13 A catch-up efficiency challenge[67], based on GDNs' relative performance over the RIIO-GD2 period, was applied to the results from the regression and non-regression modelling.

5.14 Technically assessed costs (6% of total forecast costs) included large capex and repex projects, and the majority of bespoke outputs and specialist areas, such as gasholder demolition and physical security expenditure. These were subject to technical and engineering reviews, but we did not apply a catch-up efficiency challenge to these costs.

Options for evolving our cost assessment approach for RIIO-GD3

5.15 In this section, we set out our evolved thinking on the RIIO-GD3 cost assessment approach, covering:

- our **approach to cost modelling,** ie the level at which we choose to assess costs, the modelling techniques in our assessment toolkit and the cost drivers specified in the models;
- the application of pre-modelling **normalisations and adjustments** to the data to enable robust comparative analysis. This includes regional and company specific factors, workload adjustments and cost exclusions; and
- **other considerations** for the cost assessment methodology including our approach to separate assessments, pass-through cost items and the approach to the disaggregation of final allowances.

5.16 For each area above, we review the SSMC position, summarise consultation responses, and highlight relevant stakeholder engagement and feedback from

[66] The model used ordinary least squares estimation with Cobb-Douglas functional form and a composite scale variable (CSV) as the main cost driver. The time period of data used covered RIIO-GD1 and RIIO-GD2. To account for unobserved time effects, the model specification also included two linear time trends - one for historical data and another one for the forecast period.
[67] The efficiency challenge was set at the 75th percentile of the efficiency scores in the first year of RIIO-GD2, followed by a glide path to the 85th percentile by the last two years of RIIO-GD2.

recent CAWGs. We also draw comparisons with the approaches taken in the RIIO-GD1&2 and RIIO-ED2 price controls where appropriate.

Approach to cost modelling

5.17 Econometric analysis, or benchmarking, will continue to be our primary cost assessment tool for RIIO-GD3. To develop our approach, we will test models at different levels of aggregation and for different cost drivers. This will provide information to assess GDNs' comparative efficiency and make adjustments to their submitted totex.

5.18 As outlined in our SSMC, there are three approaches for aggregating and modelling costs that we typically deploy at cost assessment. A cost modelling framework may rely on a single model, or a combination of these approaches.

- **Totex (or top-down) benchmarking** has the advantage of being a simple comparative analysis across GDNs. It is largely immune to trade-offs between cost activities and reporting differences and therefore is less susceptible to the statistical issues of a dataset with a relatively small sample size. Because of this, it typically provides a more statistically robust comparative analysis across the GDNs when compared with the other benchmarking approaches. We also consider that totex benchmarking effectively encourages GDNs to deploy the lowest cost solution to a problem over time. A criticism of totex benchmarking is that the model can lead to a less intuitive relationship between costs and cost drivers. It is also more difficult to determine a narrative as to why companies may be deemed inefficient, when compared to more disaggregated models.
- **Middle-up modelling** benchmarks broad blocks of expenditure, but at a more disaggregated level than totex. Depending on the aggregation of costs and the cost drivers selected, this approach can be useful in providing a different perspective for cost assessment and insights on the causes of inefficiency. Criticism of this approach lies in it not addressing trade-offs between capex and opex or between other cost groupings, meaning results may not reflect true differences in relative efficiency.
- **Disaggregated (or bottom-up) modelling** assesses individual cost activities, potentially using different techniques. This has the advantage of allowing a better specification of the relationship between cost and cost drivers and can be useful for cost areas with specific outputs associated with them. Criticisms of this approach include the risk of 'cherry picking'

as when modelled efficient costs of individual activities are aggregated back together to get a totex view, we might create a theoretically efficient that might not be realistic. Results can also be impacted by different business practices or a different mix between opex and capex, so they are not always a good reflection of the differences in relative efficiency between companies.

SSMC summary

5.19 In our SSMC we recognised that the single totex model used at RIIO-GD2 performed robustly. The model achieved a high adjusted R-squared and passed most post-estimation statistical robustness tests. We stated that the model provided the right starting point for RIIO-GD3 model testing.

5.20 However, to provide a richer view of relative efficiency, we proposed to explore alternative modelling approaches and potentially the use of multiple models as part of model testing for RIIO-GD3. For example, we noted that combining multiple totex models could provide a more diverse top-down view of efficiency through the use of a greater variety of cost drivers, different time periods, and modelling techniques. We also considered the benefits of middle-up and disaggregated modelling, and noted that a combination of different cost aggregation approaches could provide an alternative view of totex to go alongside top-down modelling, or be used to validate the results of our totex benchmarking.

5.21 We stated our intention to test different cost drivers and considered it important to assess potential cost drivers against the principles used at previous price controls. These required cost drivers to make economic and/or engineering sense, be accurately and consistently measurable, display a relatively stable relationship with costs, and be beyond the control of the network companies where possible.

5.22 In summary, we noted that the precise mix of modelling techniques - ie the level of cost aggregation, the model specification and the cost drivers used - will depend on a model's performance against a set of evaluation criteria. We summarised the high-level evaluation criteria applied at RIIO-GD2 and proposed to use these again for RIIO-GD3:

- Rationale: Are choices of explanatory variables consistent with economic and engineering rationale?
- Consistency with RIIO-GD3 policy: Is the model consistent with policy and regulatory objectives?
- Reliability: How reliable is the available data?

- Transparency: Are the model results transparent and easy to interpret?
- Robustness: Does the model pass statistical tests/requirements?

5.23 In our consultation questions, we asked for stakeholder views on the advantages of multiple totex models, possible alternative cost drivers for testing, and the potential use of middle-up and disaggregated modelling. We also asked how disaggregated cost activities could be combined to form a complete middle-up or bottom-up assessment of totex.

Summary of consultation responses

5.24 All stakeholders supported the continuation of totex modelling for RIIO-GD3, with GDNs agreeing that the RIIO-GD2 model performs well and provides a good starting point for model testing. There was broad support for considering multiple totex models. A GDN argued that changes from using a single totex model must have clear benefits. Several other responses noted that if multiple totex models are employed they should not reduce the overall statistical robustness. One suggestion was for Ofgem to conduct early totex model testing for structural breaks and non-linear functional form.

5.25 The feedback received on the potential of middle-up and disaggregated modelling approaches was more mixed. Most responses agreed with the relative merits we identified in the SSMC for assessing costs using the top-down, middle-up and bottom-up approaches. However, many respondents agreed that middle and bottom-up approaches largely serve to help validate the results from the totex model, as they are not robust enough to be suitable for setting allowances. It was argued by one GDN that the data sample for the gas distribution sector is too small to consider more granular approaches than the totex level.

5.26 With regard to the right configuration of cost pools for middle-up modelling and disaggregated benchmarking, it was noted that these are difficult to define, and different levels of aggregation would need to be tested once business plan data for RIIO-GD3 is available. Ofgem should continue to engage with stakeholders going forward to help define suitable cost pools for testing and model validation.

5.27 Whilst stakeholders supported the use of disaggregated activity analysis for the purposes of separately assessed bespoke activities, several GDNs shared concerns that the previous bottom-up models did not form a reliable basis for setting totex allowances due to cost inconsistency issues. This was driven by factors including different interpretations of the regulatory guidance and company approaches that can cause costs to be reported differently. One stakeholder

encouraged a thorough review of the data needed for disaggregated analysis to ensure that it was fit for purpose.

5.28 One GDN stated that disaggregated modelling would be a useful approach within the RIIO-3 toolkit to aid transparency of determining cost efficiency, for example by considering more intuitive cost comparator techniques such as unit rate analysis. However, another GDN argued that unit cost benchmarking is not as robust in determining efficiency and warned against moving away from regression-based approaches as these account for more exogenous variation in costs. If disaggregated models are used to inform allowances, one GDN noted that it is important that the efficiency benchmark is determined at the aggregate level in order to avoid 'cherry picking' across different costs areas which would not effectively incentivise totex efficiency. There was generally greater agreement amongst respondents that disaggregated modelling is mostly useful, in certain areas, to re-evaluate and establish cost-cost driver relationships for the totex model specification, rather than to set totex allowances.

5.29 With regards to cost drivers, there were some suggestions of alternative variables to consider, but the emphasis from stakeholders was to focus on refining existing RIIO-GD2 cost drivers in the totex composite scale variable (CSV). Specific suggestions on cost driver related areas to review included:

- the calculation of Modern Equivalent Asset Value (MEAV) and the repex synthetic cost driver For example, one GDN argued that the relationship between Work Management costs and MEAV is no longer robust and would need further development;
- the RIIO-GD2 approach to weighting the components of the CSV and the need to consider alternatives to using industry average spend proportions;
- the need to capture increasing cost pressures expected in RIIO-GD3 - there was concern that using cost drivers that possess a stable relationship with costs might not adequately capture cost increases;
- giving more weight to operational insight/engineering rationale over statistical performance; and
- considering new approaches such as principal component analysis (PCA) and factor analysis to help determine statistical relationships.

SSMD decision and rationale

5.30 We will continue with model testing after SSMD and do more work with stakeholders through the CAWGs. We have taken on board many of the feedback

points received and have already started considering these in the preliminary testing described below.

5.31 Following SSMC, we continued with some early model testing and analysis focused on re-visiting totex and middle-up models tested at RIIO-GD2. We have done this in close collaboration with the GDNs and shared results through the CAWGs. This testing was performed with the RIIO-GD2 dataset updated with the latest historical information.[68]

5.32 The first task of our preliminary testing was to re-run the RIIO-GD2 totex model with the updated dataset. This suggests that the model specification from RIIO-GD2 remains a strong starting point for RIIO-GD3 testing.

5.33 We also re-evaluated the RIIO-GD2 middle-up model specifications for Capex, Opex, and Repex with the updated dataset. Our initial findings were similar to the conclusions from RIIO-GD2 - all three models were weaker than the top-down totex model in terms of adjusted R-squared. Whilst results from the individual models appear to provide some different insight into the relative efficiency versus the totex model, combining the results presents a very similar picture of relative efficiency to the totex regression.

5.34 Finally, we revisited various alternative models for both totex and other cost pools using the updated dataset. This demonstrated that alternatives to the RIIO-GD2 totex CSV performed robustly and are worth exploring further. Using single scale variables such as MEAV or throughput produces similar results while an alternative CSV, consisting of customer numbers, network length and throughput, also produces promising results. Another key initial observation is that whilst MEAV demonstrates a strong relationship with overall totex, it may not be a particularly robust driver for elements of opex such as Work Management and Business Support - a point argued by one GDN during the fourth CAWG. However, our initial analysis suggests that MEAV performs considerably better as an explanatory variable once capex is added to the cost pool.

5.35 Our preliminary testing has proven useful in considering the next steps for RIIO-GD3 cost model development. However, it is too early to make any definitive decisions around cost aggregation, cost drivers, and model specification. This is aligned with the views of the GDNs from their SSMC responses and the CAWGs.

[68] The forecast data was replaced with outturn values for the years 2020/21, 2021/22, 2022/23). The updated dataset presented some inconsistencies, due to the challenge of updating the RIIO-GD2 BPDT inputs with data from the RRPs. However, following a comprehensive QA process and engagement with the GDNs, we considered it suitable for preliminary testing.

We will resume model testing when we receive the draft forecast cost information in the draft BPDT submissions. Our next steps include:

- repeating much of this preliminary testing using the full historic and forecast dataset submitted through the RIIO-GD3 BPDTs, as well as extending the testing to consider alternative time periods;
- refining the RIIO-GD2 totex CSV for RIIO-GD3 by assessing the role of MEAV, recalibrating the synthetic workload drivers, and considering alternative CSV weightings;
- exploring alternative cost drivers and CSVs at a totex level as well as using middle-up and disaggregated modelling. We will continue to review and refine the principles set out in our SSMC and summarised in paragraph 5.21, taking onboard stakeholder views. We will evaluate potential cost drivers against these principles;
- assessing alternative candidate models against the high-level evaluation criteria of logic, robustness, reliability and transparency outlined in our SSMC and repeated in paragraph 5.22. We are minded to retain these criteria as we consider these are well tested from previous price controls and remain valid. For example, alternative totex models will need to meet a sufficient level of statistical robustness as well as contain cost drivers that are supported by strong economic and engineering rationale; and
- considering a multiple totex model approach and how to combine the results of different models.

Normalisations and adjustments

5.36 Pre-modelling normalisations and adjustments made to submitted data are a crucial step in cost assessment - whether for top-down, middle-up or bottom-up approaches. They help ensure network company submitted costs are on a comparable basis prior to modelling and benchmarking. These adjustments include:

- Reclassifications: reclassify costs from one activity to another when they have been reported incorrectly or differently to other company submissions;
- Regional and company-specific factors: adjustments made to cost allowances to reflect specific factors that might mean the efficient level of costs is higher in some regions than others;

- Workload adjustments: adjustments to forecast volumes of work, where we consider the volumes to be inefficient or lack justification; and
- Exclusions: excluding costs from the modelling altogether when they are not explained by the cost drivers used, or where there is a substantial change in the nature of the activity being undertaken. This is sometimes the case for costs associated with bespoke outputs or large capex investments.

5.37 Below we review the SSMC position, summarise consultation responses, and outline our evolved thinking for RIIO-GD3.

5.38 We do not review the role of reclassifications in detail below as the SSMC did not directly ask for feedback. In our SSMC, we proposed to limit the number of reclassifications through the development of clear business plan and BPDT guidance. Some stakeholders highlighted in their responses the need for clear distinction and categorisation of cost activities to avoid reclassifications. Since SSMC, we have worked with stakeholders to develop a robust BPDT and guidance as well as refining the BPI which places weight on good data reporting.

Regional factors

SSMC summary

5.39 In our SSMC, we recognised the importance of controlling for costs differences outside of the network companies' control that are due to regional factors. We stated that, where necessary, we intend to continue to account for the regional factors of labour, urbanity, and sparsity in RIIO-GD3. We also noted that we are open to alternative approaches that account for these differences, and we will look to revisit within-modelling approaches.

Summary of consultation responses

5.40 We received mixed feedback on the potential application of regional factor adjustments at RIIO-GD3. Some stakeholders suggested that the previous RIIO-GD2 approach did not sufficiently address regional differences, while others questioned the need for regional factor adjustments at all.

5.41 On regional wage disparities, two GDNs suggested that Ofgem should review the application of the RIIO-GD2 adjustment. One GDN argued that the ONS ASHE dataset used to calculate the regional wage adjustment does not fully reflect the cost of contractors in the south of England. Another GDN focused on the

geographical definition of regions receiving an adjustment. At RIIO-GD2, only the 'London' and 'South-East' regions received a regional labour adjustment. It argued that excluding the 'East' region from an adjustment is inconsistent as evidence from average wages suggest areas within this region are subject to the same labour market forces as areas of the 'South-East' region. The GDN proposed that Ofgem modify the boundaries for the regional adjustment to include areas within the 'East' region that directly border London.

5.42 Two other factors affecting regional labour, noted by the GDNs, were the additional cost of a risk premium experienced within southern regions for contractor labour caused by greater demand and a lower supply of workers; and the increased disparity in labour costs due to higher employer national insurance contributions in regions with higher wages. One GDN felt it important that regional factor adjustments are properly validated through top-down and bottom-up cost approaches, to ensure that they are not conflated with genuine managerial inefficiency or noise in the cost data. It stated that pre-modelling adjustments should not benefit companies disproportionately and need to be a fair reflection of regional differences. The GDN cited a potentially disproportionate impact on allowed repex unit costs due to the RIIO-GD2 regional labour adjustment. It also highlighted that pre-modelling adjustments applied in RIIO-ED1 may have overstated the impact of regional factors on efficient costs, and proposed that similar analysis is carried out for RIIO-GD3 to ensure the regional wage adjustment is valid.

5.43 Regarding the London urban productivity adjustment[69] at RIIO-GD2, one GDN noted that this exhibited strong correlation with the adjustment for regional wages, and therefore suggested that there is a risk that the 'urbanity' impact is double-counted. Conversely, another GDN argued that the adjustment could be extended to additional cost categories.

5.44 Respondents generally agreed that the RIIO-GD2 methodology for regional adjustments relating to sparsity is a reasonable starting point for RIIO-GD3. However, two GDNs argued that the application of the sparsity adjustment should be extended beyond emergency and repair activities, highlighting other key activities such as Repex and Maintenance which are impacted by sparsity.

[69] This is a pre-modelling adjustment to Reinforcement, Connections, and Repex costs to reflect lower labour productivity associated with working in the London area, based on an assumed 1.15 London urbanity factor.

5.45 An alternative to the pre-modelling adjustments for urbanity and sparsity related factors is the use of an exogenous density variable within-modelling. This approach was strongly supported by one GDN that argued that density modelling should be considered as a complementary method alongside pre-modelling adjustments. It suggested testing both network density and population density variables, and that these could be combined with another totex model (or as pre-modelling adjustments) in a multiple-model approach. Another GDN supported pre-modelling over within-modelling adjustments as they enable greater transparency. Whilst a within-model approach could be useful to ensure correct calibration of pre-modelling adjustments, it argued that there is significant risk that these do not produce statistically robust results as well as account for both density and sparsity effects.

SSMD decision and rationale

5.46 During the preliminary model testing (discussed in paragraph 5.31), we recalculated the regional wage indices with updated data from the ONS ASHE for 2020 to 2023. We also began revisiting density variables first tested during the RIIO-GD2 model development. Our initial observations included:

- London wages have increased more slowly compared to the rest of the UK in recent years. This leads to slightly lower wage indices and a reduced adjustment for the London and South-East regions;
- application of the pre-modelling adjustments improves totex model fit; and
- the inclusion of a density variable (customers per km of network) indicates higher costs when operating in more dense areas (ie the estimated coefficient has a positive sign and is statistically significant). However, when including a density-squared variable, the estimated coefficient is not statistically significant, suggesting there is no presence of higher costs for both dense and sparse areas.

5.47 It is too early to draw firm conclusions from this preliminary work and, as described in paragraph 5.35, we plan to repeat the initial testing using the full historical and forecast dataset submitted through the RIIO-GD3 BPDTs. Based on this, and the feedback to SSMC, we identified three key areas to focus on to evolve our approach to regional factors:

- recalibrating and re-validating all pre-modelling regional factor adjustments, including the geographical boundaries for the labour adjustment;

- reconsidering the cost activities that regional factor adjustments are applied to; and
- exploring within-modelling density variable approaches, either as a substitute for the pre-modelling adjustments, or as an alternative in a multiple totex model approach. Additional testing and thorough QA are required to assess the suitability of density variables for RIIO-GD3.

Company-specific factors

SSMC summary

5.48 Company specific factors are drivers of costs, that are due to the inherent nature of a particular network, and result in higher efficient costs for a GDN relative to the rest of the sector. These costs are beyond the control of the GDN but are not captured by regional factor adjustments. In RIIO-GD2, we excluded some costs prior to benchmarking where GDNs had provided sufficient evidence of a company specific factor.

5.49 At SSMC, we proposed to use the same criteria from RIIO-GD2 when assessing company specific factors. These criteria require that each individual company-specific factor claim should:

- have a materiality threshold of 0.5% of a GDN's gross unnormalised totex;
- be unique in nature to a single or small number of GDNs;
- be outside the control of the GDN;
- be excluded from the cost drivers used in the econometric modelling; and
- be excluded from other adjustments such as regional factors.

Summary of consultation responses

5.50 All respondents agreed on the need to retain adjustments for company-specific factors. Several GDNs stated that our approach and assessment criteria used in RIIO-GD2 were appropriate for RIIO-GD3. One GDN agreed with the majority of criteria but suggested lowering or removing the 0.5% materiality threshold. It raised the concern that a collection of multiple company-specific factors could be material when combined and that individual claims that fell below this threshold might be considered immaterial.

5.51 Another GDN suggested that Ofgem investigates potential benefits from economies of scale from bulk purchasing for asset replacement, as well as sharing

business support costs across multiple licensees. It noted that while the presence of group-level economies of scale have been accepted in some previous price controls, eg for business support costs in RIIO-ED2, the cost modelling at RIIO-GD2 did not account for group-level effects. The GDN argued that if this approach is continued for RIIO-GD3, then Ofgem should consider a pre-modelling company-specific factor adjustment that reflects the additional costs experienced by single licensee GDNs.

5.52 One GDN highlighted the potential to improve the recognition of company-specific factors for RIIO-GD3, and cited the acceptance by Ofgem of certain claims at RIIO-ED2. It stated its intention to strengthen evidence on company-specific factors for RIIO-GD3 by comparing costs across as many networks as possible, utilising a greater variety of data, and building on the precedent set at RIIO-ED2.

SSMD decision and rationale

5.53 Our current view for RIIO-GD3 is to continue to use the same criteria when assessing company specific factor claims. This includes continuing to apply a materiality threshold of 0.5% of a GDN's gross unnormalised totex. We consider that the application of a threshold is both appropriate and important as it sets a clear, proportionate requirement. If removed, there may be greater inconsistency where some GDNs submit minor claims whilst others, who face similar company-specific factors, choose not to make a claim given their limited materiality.

5.54 We note the point around group-level scale effects and the fact that these have been recognised in the assessment and modelling of business support costs in previous price controls. We will explore this further once we resume model testing and development following draft BPDT submissions.

Workload adjustments

SSMC summary

5.55 At SSMC we said that we will continue to implement workload adjustments to Repex or other activities, when we consider that GDNs have not justified the volumes of work. However, the precise way in which workload adjustments are applied will depend on the final cost modelling approach.

5.56 For example, at RIIO-GD2 we disallowed all workloads associated with dynamic growth in Repex Tier 1 and adopted a CBA pay-back cut-off of 2037 for asset management mains investment, and as a result, disallowed a small proportion of asset management repex workloads.

Summary of consultation responses

5.57 Stakeholders generally agreed with the need for some workload adjustments in order to ensure that the cost models provide a fair assessment across GDNs. However, caution in their use was suggested, and several respondents argued that they should be minimised where possible. Specifically, it was suggested that workload adjustments applied to address different planning assumptions could be mitigated by Ofgem issuing clear guidelines on the future energy scenario required for business plan submissions. Further feedback highlighted that workload adjustments should:

- be applied in a way that avoids distorting the comparative regression assessment. For example, it was suggested by one GDN that there should be an opportunity to reallocate fixed overheads across other workloads if a specific workload is reduced/removed as the fixed element will remain;
- be adequately accounted for in the allowance setting process, so networks are fairly funded for the deliverables they have committed to. One GDN argued however that networks submitting costs below their modelled efficient costs should be allowed their submitted costs *excluding* workload adjustments, to incentivise and reward the submission of ambitious plans;
- be transparent and distinct from any adjustment for cost efficiency. For example, one GDN argued that the RIIO-GD2 approach for assessing streetworks implicitly made judgements about workload and efficiency by assuming both unit costs and activity workloads are fixed. Together with the application of the catch-up challenge, this led to double-counting of expected efficiencies and set a stretching allowance with little precise information on the workloads expected to be delivered.

SSMD decision and rationale

5.58 We will continue to apply workload adjustments in RIIO-GD3 where we consider that GDNs have not justified the volumes of work. We agree with the need to minimise the use of workload adjustments for addressing differences in planning scenario assumptions, and we have issued clear guidelines on future energy scenario requirements for draft and final business plan submissions in the Business Plan Guidance. However, where they are required, we consider the most suitable stage to apply any workload adjustments remains pre-modelling. Ultimately, we will aim to finalise the application of workload adjustments as we develop the overall cost modelling approach ahead of Draft Determinations.

Exclusions

SSMC summary

5.59 At SSMC we stated that we will continue to make exclusions of historical and forecast costs where assessment outside of the standard benchmarking models is required, to ensure comparability across GDNs. We said that decisions to exclude any costs should be made based on a set of upfront criteria and we welcomed views on what they should be.

5.60 In RIIO-GD2, we excluded historical and/or forecast costs based on the following criteria:

- costs not well-represented by the drivers in the totex regression model;
- large capex projects above £5m in materiality; and
- bespoke outputs and other uncertain costs where GDNs had taken different approaches.

5.61 Based on the criteria above, cost areas excluded from the regression model at RIIO-GD2 included gasholder demolition, cyber and physical security, MOBs, streetworks, repex diversions, smart metering, land remediation, SIU opex, and growth governors. An example of large capex projects excluded was LTS rechargeable diversions. An example of bespoke and uncertain costs excluded was the consumer vulnerability costs for SGN and WWU, which were funded separately through a common output.

Summary of consultation responses

5.62 Stakeholders were generally in agreement that the RIIO-GD2 criteria for exclusions should be retained. Several respondents emphasised that while Ofgem will need to conduct further analysis and review final business plans in order to determine cost exclusions, the exclusion criteria should be established as early in the process as possible and applied consistently.

5.63 Two GDNs questioned the £5m materiality threshold. One GDN suggested that it should only be a guideline and cover repex as well as capex projects. The other GDN proposed that the materiality for projects should be reduced to £2m. Another GDN agreed with the need for a materiality threshold but argued that an aggregated level is considered in case multiple cost areas/projects are material to a company, but only in aggregate.

5.64 Another respondent did not propose a change to the materiality threshold and said that exclusions should only relate to large-scale, one-off projects. It

suggested that as a first principle, as many areas of spend as possible should be included in the cost assessment modelling, with a high bar for exclusions. It also proposed that exclusions from RIIO-GD2 are reviewed and considered for inclusion in cost modelling for RIIO-GD3.

5.65 One GDN proposed that the quality of historical information be included as a principle, arguing that costs should be excluded where there is poor quality or inconsistent historical data to base future expenditure upon. However, another GDN commented that a limited historical comparison should not necessarily mean costs should be excluded provided costs are still common to all networks. It maintained that exclusions should only be for heterogeneous areas of expenditure that are not comparable between GDNs.

5.66 When referencing specific areas of expenditure for exclusion, two respondents proposed a continuation of the exclusions from RIIO-GD2 such as MOBs, street works, repex diversions, smart metering, land remediation, and SIU opex. However, one GDN noted growth governors as an area that should be considered for inclusion in totex modelling. On the other hand, examples of additional cost items proposed for exclusion at RIIO-GD3 by stakeholders included large and/or atypical repex projects, data and digitalisation, cyber and physical security expenditure, non-operational IT, and built over mains. Further discussion on the potential inclusion/exclusion of specific cost areas at RIIO-GD3 follows in the next section on the approach to separate assessment.

SSMD decision and rationale

5.67 Our current position for RIIO-GD3, is to retain as many cost areas/activities as possible within our primary cost modelling. This is to support a comprehensive and robust assessment of overall totex efficiency. We recognise however, that it will be necessary to make some exclusions and we think that the criteria applied at RIIO-GD2 provide a suitable starting point for RIIO-GD3. We are minded to retain the materiality threshold for large projects at £5m, but we intend to consider both large and atypical repex projects for exclusion as well as capex projects. We also acknowledge the point regarding the quality of historic information, and we will review this as part of our future work. We will aim to refine the criteria in the coming months and work with the GDNs via the CAWGs to establish clear criteria early ahead of final business plan submissions.

Other considerations

Approach for separately assessed costs - non-regression analysis and technical assessment

5.68 As described above, through exclusions and company-specific factor adjustments, we remove some costs that are not suitable for regression-based benchmarking. This can be for several reasons, including where:

- variations in costs across GDNs are not well represented by the regression model cost drivers; or
- the discrete nature of certain investments carried out by the GDNs limits our ability to model costs and apply a comparative benchmark. This can be due to factors such as a lack of historical comparators or the unique characteristics of an area (or project).

5.69 To separately assess these costs in RIIO-GD2, we used a variety of quantitative and qualitative techniques that involved non-regression benchmarking and analysis or detailed technical assessments that relied upon expert engineering review.

SSMC summary

5.70 At SSMC we proposed that non-regression analysis and technical assessment would remain part of our cost assessment toolbox for any costs excluded from econometric benchmarking for RIIO-GD3.

5.71 We highlighted the cost activities previously assessed through non-regression analysis, which included MOBs, diversions, growth governors, streetworks, smart metering, land remediation, and SIU opex. We noted that costs assessed through non-regression analysis were subject to a catch-up efficiency challenge. Our SSMC position was to continue to apply non-regression analysis as a tool for separate assessment where it is required to support our econometric modelling in RIIO-GD3. However, the extent to which we use non-regression analysis would depend on the development and design of our cost modelling approach. We said that in RIIO-GD3 we might seek to increase the overall cost pool covered by our primary totex assessment, so the use of non-regression analysis could be reduced compared with RIIO-2.

5.72 Regarding technical assessment in RIIO-GD2, we noted that this included bespoke repex programmes, major project capex investments, and gas holder demolition costs. Only the direct project costs were technically assessed, with

indirect costs remaining in totex benchmarking. All technically assessed costs were excluded from the application of the catch-up efficiency challenge but were subject to ongoing efficiency. We recognised that there will be a need to technically assess some costs in RIIO-GD3. We said we would continue to use expert and engineering qualitative reviews and that we consider it important for the assessment to be proportionate to the magnitude of costs involved.

5.73 We also highlighted an alternative technical assessment approach using the Demonstrably Inefficient and Wasteful Expenditure (DIWE) framework previously suggested by a GDN. Under this approach costs would not undergo an ex ante technical assessment, but assumed efficient and assessed ex post if necessary.We asked for views on the approach to, and suitable cost areas for, technical assessment and non-regression analysis at RIIO-GD3. We sought suggestions of cost areas that could be included in totex benchmarking, despite being separately assessed at RIIO-GD2, and we also requested feedback on alternative technical assessment approaches.

Summary of consultation responses

5.74 There was general agreement to continue to apply non-regression analysis to certain cost areas as at RIIO-GD2. For streetworks, two stakeholders suggested using the most recent historical and forecast data to better capture cost increases. One GDN argued that while it supports the assessment of streetworks costs at a GDN-specific level, the RIIO-GD2 non-regression assessment used a long-term historical average that did not accurately reflect the true level of cost and activity experienced in the price control period. Noting the improved approach taken by Ofgem at RIIO-ED2, it proposed modifying the non-regression assessment for RIIO-GD3 to consider the most recent period of data and account for additional drivers such as the number of streetworks schemes.

5.75 As noted in paragraph 5.665.66, one GDN argued that the treatment of growth governors as an area for non-regression assessment was inconsistent, and that this activity should be included in the primary totex regression model. It commented that equivalent network reinforcement can be achieved via longer and bigger pipe which, unlike growth governors, was included within the totex regression at RIIO-GD2. It argued that this overstates the efficiency of networks who predominantly use growth governors and understates the efficiency of those who use pipe lay solutions. The GDN proposed that growth governors be added to the reinforcement synthetic workload driver so that the associated costs can be included in regression modelling.

5.76 Two GDNs said that the application of the catch-up efficiency challenge to non-regression assessed costs is inconsistent with the rationale for why the costs are excluded from the regression. They argued that applying the challenge unfairly penalises networks that incur high costs in these areas, and double counts the challenge given that the non-regression assessment has already embedded an efficiency challenge in the modelled costs. They proposed that non-regressed costs, like technically assessed costs, should not be subject to the catch-up challenge.

5.77 Respondents generally agreed with the approach to technical assessment in RIIO-GD2 and felt that it would be appropriate for RIIO-GD3. Several GDNs stated that a combination of qualitative and quantitative technical assessment approaches, including expert engineering reviews, should be retained, unless there are clear benefits for changing the approach. One GDN commented that expert engineering reviews are particularly beneficial for assessing large bespoke capex and repex projects. However, another GDN suggested that, while there was little alternative to expert engineering reviews, there has at times been a lack of transparency for why specific decisions have been made when technically assessing certain areas, whether cost efficiency and/or workload related. It suggested that Ofgem should work collaboratively with GDNs when undertaking expert engineering reviews to ensure that decisions are clear.

5.78 Two GDNs proposed that LTS related expenditure, and specifically LTS diversions, should be considered for separate technical assessment in RIIO-GD3. They both argued that there is no driver in the totex regression model that adequately accounts for costs differences across the sector. One GDN stated that elements of cyber security expenditure should not be separately technically assessed in RIIO-GD3, instead proposing that they be considered for cost benchmarking given the increased history of delivery since RIIO-2.

5.79 We received some comments on alternative approaches to technical assessment. One GDN suggested that reference models could be used to benchmark GDNs where a hypothetical efficient company is created using mathematical optimisation and capex unit costs to redesign the network. However, it noted that the approach is likely to be overly complex and rely heavily on assumptions. Another GDN did not support the use of the DIWE framework. It argued that having a clear ex ante assessment helps reduce risk, and whilst the intention of the approach is to streamline the cost assessment process, it considered that it would in fact add to the regulatory burden in the long term.

SSMD decision and rationale

5.80 For RIIO-GD3, we will continue to apply non-regression analysis and benchmarking as a tool for separate assessment where it is required to support our econometric modelling. The extent to which we use these techniques will depend on the data received through the business plans, and the development and design of our cost modelling approach. We welcome the feedback received from stakeholders so far and we plan to revisit the non-regression assessment of certain cost areas, noting the specific points on growth governors and streetworks. We will continue to collaborate with the GDNs through the CAWG process as we develop analysis in these areas ahead of our Draft Determinations.

5.81 For RIIO-GD3, we have decided to rule out making any substantial changes to the technical assessment approach, and our minded to position is to rely on expert engineering reviews as at RIIO-GD2. We consider that moving to an ex-post assessment could place additional risk on consumers and potentially increase the regulatory burden. We also agree with the comment that a reference model approach would be too complex. For RIIO-GD3, it will be important that the costs subject to the expert-led engineering technical assessments meet the RIIO-3 EJP requirements. Finally, we note the concern raised about the lack of transparency of decision-making regarding engineering reviews at previous price controls. We will aim to work with the GDNs where possible throughout the technical assessment process to ensure decisions are clearly set out at Draft and Final Determinations.

Pass-through costs

SSMC summary

5.82 Within RIIO there is a set of specific cost areas that network companies can pass through to consumers due to the limited control they have in managing them.

5.83 Pass-through mechanisms such as business rates, bad debt, Ofgem license fee and pension scheme established repair apply to more than one sector and are covered in the Overview Document. Our SSMC position was to retain all the pass-through mechanisms for RIIO-GD3.

SSMD decision and rationale

5.84 Our decisions on GDN specific pass-through items, as well as stakeholders feedback, are set out in the table below.

Table 4: Summary of our pass-through decisions for RIIO-GD3.

Description	**Summary of December Proposal**	**Response**	**Decision**
Pension deficit charge adjustment: this mechanism ensures that the pension deficit costs incurred by National Gas relating to its former employees are appropriately recharged to the GDN customers that these employees serve.	Retain from RIIO-GD2. We intended to treat these costs as pass-through.	Stakeholders agree with Ofgem's SSMC position.	We will treat these costs as pass-through. GDNs have no control over the costs relating to the deferred and pensioner liabilities associated with NGT's former gas distribution employees.
Third-party damage and water ingress: this pass-through mechanism allows the GDNs to recover the cost of interruptions caused by third party damage or water ingress.	Retain from RIIO-GD2. We intended to treat these costs as pass-through.	Stakeholders agree with Ofgem's SSMC position.	We will treat these costs as pass-through. GDNs have no control over costs incurred under GSOP1 (Supply restoration) and Section J of the Network Code as a result of third-party damage or water ingress.
Shrinkage	Retain from RIIO-GD2. We intended to treat these costs as pass-through.	Stakeholders agree with Ofgem's SSMC position.	We will treat these costs as pass-through. GDNs have no control over costs related to purchase of replacement gas to cover volumes lost to shrinkage in the distribution network.
NTS exit capacity	Retain from RIIO-GD2. We intended to treat these costs as pass-through.	Stakeholders agree with Ofgem's SSMC position.	We will treat these costs as pass-through. GDNs have no control over costs related to booking National Transmission System (NTS) exit capacity for each year to meet 1-in-20 obligations.
Theft of gas (supplier responsible): this mechanism allows the GDNs to pass-through the costs relating to investigating gas illegally taken (on behalf of shipper/suppliers).	Retain from RIIO-GD2. We intended to treat these costs as pass-through.	Stakeholders agree with Ofgem position.	We will treat these costs as pass-through. GDNs have no control over costs related to unsuccessful gas theft investigations by gas suppliers and work to make pipes safe at the request of suppliers following tampering or illegal reconnection.
Central Data Service Provider (CDSP) Costs: provides for	Retain from RIIO-GD2. We intended to	Some respondents argued that	We will treat these costs as pass-through. The current governance arrangements

Description	Summary of December Proposal	Response	Decision
the Gas Transporters' share of Xoserve costs.	treat these costs as pass-through.	CDSP costs are within companies control and the change in governance arrangements may remove the efficiency incentive on these costs.	require industry (including National Gas, the GDNs and other users of CDSP services) to fully engage in setting and scrutinising Xoserve's CDSP costs annually, which provides oversight. We expect National Gas and the GDNs, together with other CDSP users, to engage fully in the CDSP budget setting process and work collaboratively to ensure these costs are efficient and services fit for purpose.
Miscellaneous: This can be used to recover costs incurred by the GDNs that are not reflected elsewhere in the pass-through licence condition.	Retain from RIIO-GD2. We intended to treat these costs as pass-through.	Stakeholders agree with Ofgem's SSMC position.	We will treat these costs as pass-through. Minor uncontrollable costs incurred by GDNs that are not funded elsewhere in the price control.
Stranraer (bespoke -SGN only): Covers the capacity booking costs for the private transmission pipeline that supplies the Stranraer Local Distribution Zone - a previously independent network that used to be classified as a Statutory Independent Undertaking (SIU).	Retain from RIIO-GD2. We intended to treat these costs as pass-through.	Stakeholders agree with Ofgem's SSMC position.	We will treat these costs as pass-through. The capacity booking costs are non-controllable in the same way as those covered by the NTS exit capacity pass-through. A separate bespoke pass-through is required as the pipeline is owned by Premier Transmission.
Costs relating to energy code reform	Not considered for pass-through costs in SSMC	A GDN suggested creating a pass-through for costs resulting from the creation of code managers resulting from our joint project with DESNZ on	We have not yet decided how code managers will recover their costs, so it is premature to create a pass-through item at this stage. If appropriate following our decision, we will consider if (and how) RIIO-3 should support these reforms in our Draft Determinations.

Description	Summary of December Proposal	Response	Decision
		energy code reform.[70]	
Joint Office of Gas Transporters (JO) costs	Not considered for pass-through costs in SSMC	A GDN suggested creating a pass-through for costs relating to the delivery of JO services.	We have decided not to treat these costs as a pass-through item - JO costs should continue to be funded through baseline allowances. While the JO has been transferred to a new limited company, it is still funded and governed by the GDNs and National Gas, as required in the licence. We therefore consider these costs are mostly in their control and it would not be in consumers interests to make this a pass-through item. We will consider interactions with the energy code reform when setting baseline allowances for JO costs.
Costs to support RESPs	Not considered for pass-through costs in SSMC	A GDN suggested creating a pass-through for costs to support the RESPs.	We have decided not to treat these costs as a pass-through item as we consider these to be within the GDNs' control. Our decisions on how to treat costs relating to RESP recommendations and coordinating with RESPs are set out in paragraphs 2.74 and 2.75.

Disaggregation of allowances

5.85 While GDNs submit forecasts costs at an activity level, cost assessment approaches produce modelled allowances at a totex level. However, allowances ultimately need to be broken down into several cost categories for the Price Control Model (PCFM) as well as volume drivers, PCDs and other price control mechanisms It is also important to have allowances disaggregated at a cost activity level for comparison against submitted costs, and to monitor in-period performance.

[70] https://www.ofgem.gov.uk/energy-policy-and-regulation/policy-and-regulatory-programmes/energy-code-reform

SSMC summary

5.86 At SSMC we outlined how we disaggregated totex allowances in RIIO-GD2, largely relying on GDN submitted cost proportions after exclusions and reclassifications with cost shares calculated on net costs. Specifically,

- allowances were disaggregated to a specific activity/output level for variant totex activities tied to specific mechanisms. Where an activity was included in the totex benchmarking and therefore had efficient costs, allowances were split using the submitted cost proportions for that activity;
- the remaining portion of capex and repex allowances were allocated to NARM and non-NARM activities, using the submitted cost proportions; and
- where a cost activity was allocated an efficient unit cost explicitly, and not part of totex benchmarking, the unit cost was used in combination with allowed workloads to determine the allowance (ie separately assessed costs).

5.87 At SSMC we recognised the importance of this topic, but stated that, for RIIO-GD3, any decision on allocation of allowances will ultimately depend on the approach we take for modelling costs. We committed to engaging on this topic with stakeholders as we develop the cost assessment approach.

Summary of consultation responses

5.88 Depending on the cost assessment approach ultimately used, there was broad support for continuing with the RIIO-GD2 approach from stakeholders.

5.89 GDNs highlighted that disaggregation is very important regarding specific PCDs and volume drivers, and all agreed that as a starting point, totex allowances should be disaggregated at an activity level in line with RIIO-GD3 submissions.

5.90 Several respondents noted that the approach to allowance allocation was considered too late in the process for RIIO-GD2 which led to issues and errors. For RIIO-GD3, stakeholders highlighted the importance of developing the process early and maintaining engagement with GDNs to determine the allocation approach in advance of Final Determinations if possible.

5.91 Several stakeholders described other concerns with the RIIO-GD2 approach and potential issues for RIIO-GD3, summarised below.

- One stakeholder highlighted discrepancies between disaggregation of allowances and naming convention between cost assessment outputs,

PCFM and RRP reporting. It suggested aiming for more consistency in RIIO-3.

- All stakeholders noted the CMA decision from RIIO-ED2 appeals that allocating totex based upon a company's original business plan cost mix is not necessarily always appropriate. If specific and material adjustments are made during cost assessment, then there might be greater need to deviate from submitted cost shares.
- Several GDNs highlighted that while disaggregated modelling can provide an alternative source of information, it might be challenging to derive enough models to form a complete bottom-up view of totex, and at the granularity required to cover areas needing allocation.

SSMD decision and rationale

5.92 At this early stage, we intend to ensure that the RIIO-GD3 cost allocation approach is consistent with the basis of our cost assessment, uses the relevant sources of information available, is transparent and simple to implement, and is as replicable as possible across the sector to avoid any discrepancies.

5.93 Although we recognise there are some inconsistencies and minor issues that can be resolved in the RIIO-GD2 approach, we consider it broadly suitable as a starting point and default option for RIIO-GD3. Ultimately however, the final approach taken will depend on the nature of the cost assessment.

5.94 We note the limitations of submitted cost shares and the conclusions from the CMA following the RIIO-ED2 appeals. However, without an adequate suite of disaggregated or middle-up models providing an additional source of information, a totex-only approach will require the use of submitted cost shares when allocating allowances. It is important that these are suitably adjusted to reflect cost exclusions, reclassifications, and other explicit adjustments made within the cost assessment.

5.95 Finally, we recognise the need to determine the allocation approach at or ahead of Final Determinations. We will continue to engage with GDNs on this topic through the CAWGs and will develop our approach alongside the cost assessment methodology for RIIO-GD3